CONSOLIDATED EDISON INC
Form 4
July 06, 2016

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

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Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
RESHESKE FRANCES

(Last) (First) (Middle)

CONSOLIDATED EDISON COMPANY OF NY, INC., 4 IRVING PLACE; ROOM 1450-S

(Street)

NEW YORK, NY 10003

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
CONSOLIDATED EDISON INC [ED]

3. Date of Earliest Transaction (Month/Day/Year)
06/30/2016

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
SVP, Corporate Affairs

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	06/30/2016	07/06/2016	P		0.96 (1)	A	$ 76.85	45,594.06 (2)	D	
Common Stock								590.25	I	By THRIFT PLAN

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

number.

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
RESHESKE FRANCES CONSOLIDATED EDISON COMPANY OF NY, INC. 4 IRVING PLACE; ROOM 1450-S NEW YORK, NY 10003			SVP, Corporate Affairs	

Signatures

Jeanmarie Schieler; Attorney-in-Fact	07/06/2016
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Purchase of shares of common stock of Consolidated Edison, Inc. (the "Company") under the Company's Stock Purchase Plan.

(2) Total includes 386.33 Deferred Stock Units ("DSUs") acquired on June 15, 2016 pursuant to the Company Long Term Incentive Plan's dividend reinvestment provision. Each DSU represents one share of the Company's common stock.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. on Birger has served as Chief Executive Officer of Elron since 2002 and as President of Elron since 2001. He joined Elron in 1994 as Vice President - Finance and served as Chief Financial Officer and Corporate Secretary. Prior to that he served as Chief Financial Officer for a number of companies including North Hills Electronics Ltd., Middle-East Pipes Ltd., Maquette Ltd., Bateman Engineering Ltd. and I.D.C. Industrial Development Company Ltd. Mr. Birger is Chairman of Given Imaging Ltd. and ChipX Incorporated and serves as a director in several other companies in the Elron group. Mr. Birger holds bachelor and master of arts degrees in economics from the Hebrew University. AMI EREL. Ami Erel has served as President and Chief Executive Officer of

DIC since 2001. In addition, he has served as Chairman of the Board of Directors of Elron since 1999. From 1999 until 2001, he was Chief Executive Officer of Elron. He served as Chairman of the Board of Directors of Elbit Systems from 1999 until the Merger in 2000. From 1997 to 1999, he served as President and Chief Executive Officer of Bezeq - The Israel Telecommunications Corp. Ltd. and as Chairman of the Board of Directors of PelePhone Communications Ltd. from 1997 to 1998. He is Chairman of the Board of Scitex, a director of Property and Building Corporation Ltd. ,Super-Sol Ltd. and Ham-let (Israel Canada) Ltd., as well as Chairman or a member of the boards of other companies in the DIC group and the Elron group. From 2000 until January 2004, Mr. Erel served as the Chairman of the Board of the Israel Association of Electronic and Information Industries. Mr. Erel holds a bachelors of science degree in electrical engineering from the Technion. AVI FISCHER. Avi Fischer has served as the Deputy Chairman of the I.D.B. Group and as the Co-CEO of Clal Industries & Investments Ltd. (Clal) since mid- 2003. Mr. Fischer is a co-founder of the Ganden Group and has served as the Co-Chairman of Ganden Tourism and Aviation Ltd. and as the Vice Chairman of Ganden Holding Ltd. since 1999. He has practiced law since 1983 and is a Co-Managing Partner in the law firm of Fischer, Behar, Chen & Co. He currently serves on the boards of directors of IDBH, DIC, Clal, Scitex, Elron, Vyyo Inc., Natour Ltd. and other companies. Mr. Fischer holds an L.L.B. degree from Tel-Aviv University. YAACOV LIFSHITZ (EXTERNAL DIRECTOR). Mr. Lifshitz serves as a director of several companies and as a lecturer in the fields of economics, public policy and management. He currently is a lecturer at the Department of Economics and the Department of Public Policy and Management of Ben-Gurion University and at the Department of Economics and Management of the Tel-Aviv - Jaffa Academic College. He also currently serves on the boards of directors of Israel Discount Bank, DorGas Ltd., Kali - Insurance Agencies Ltd., Springs - Pension Fund Management Ltd., Carmel Investments Ltd. and Tesnet Software Testing Ltd. During the period from 1994 to 2002, Mr. Lifshitz served at various times as the chairman of the boards of directors of Hamashbir Lazarchan Israel Ltd., Israel Military Industries Ltd., Spectronix Ltd., Dor Chemicals Ltd., Dor Energy Ltd., DorGas Ltd. and the Israeli Foreign Trade Risk Insurance Corp. Ltd. He also served from 1995 to 2002 as the Chairman of the Executive Board of the Israel Management Center. Prior to that he held various senior positions in government, banking and 70 industry, including Director General of the Israel Ministry of Finance, Chief Economic Advisor to the Israel Ministry of Defense, Senior Vice President and Chief Credit Officer of Israel Discount Bank and President and CEO of Electra (Israel) Ltd. Mr. Lifshitz holds a bachelor's degree in economics and political science and a master's degree in economics from the Hebrew University. DOV NINVEH. Dov Ninveh has served since 1994 as Chief Financial Officer and a manager in Federmann Enterprises. He serves as a director of Dan Hotels and Etanit Ltd. Mr. Ninveh served as a director of El-Op from 1996 until 2000. From 1989 to 1994, he served as Deputy General Manager of Etanit Building Products Ltd. Mr. Ninveh holds a bachelor's degree in economics and management from the Technion. NATHAN SHARONY (EXTERNAL DIRECTOR). Nathan Sharony has served since 1997 as a director for several companies. He currently serves as a director for Technorov Holdings (1993) Ltd. (Technorov), a high technology investment company, Bituach Yashir Ltd., Union Bank, Ormat Industries Ltd., Genoa Technologies Ltd. and Israel Bonds International Inc. From 1997 to 1999, he served as Chairman of Technorov. From 1994 to 1997, he was employed with a U.S. brokerage firm. Mr. Sharony served as the Director General of the Israel Ministry of Industry and Trade from 1992 to 1994. Prior to that, Mr. Sharony held a number of positions in industry and government including head of the Israeli Government Economic Mission to the U.S., President and Chief Executive Officer of El-Op and Vice President for Logistics of Tadiran Electronic Industry Ltd. In 1982, Mr. Sharony completed 30 years of service in the IDF, retiring with the rank of Major General. Mr. Sharony participated in the Field Artillery Battle Officers Course in Fort Sill, Oklahoma, and studied military history at the IDF's Staff and Command College. DAVID BLOCK TEMIN. David Block Temin was appointed Corporate Vice President in 2000 and has served as General Counsel since 1996. From 1987 to 1996, he was a Legal Advisor to Elbit Ltd. Prior to that, Mr. Block Temin was an attorney with law firms in New York City. Mr. Block Temin received a juris doctor degree as well as a master of arts degree in international relations from Stanford University and holds a bachelor of arts degree in political science from the University of Maryland. He is admitted to the Israeli and New York bars. ITZHAK DVIR. Itzhak Dvir was appointed as Chief Operating Officer in June 2004, effective beginning in July 2004. He was appointed as a Corporate Vice President in 2000. Mr. Dvir served as General Manager - UAV, Tactical and Security Systems from January 2003 until his current appointment. From 2000 through 2002, he was General Manager - C4I and Battlefield Systems. From 1996 until 2000, he was Vice President and Division Manager - UAV and C3 Division. Mr. Dvir joined Elbit Ltd. in 1989 and held various management positions, including Vice President - UAV Division, Vice President -

Advance Battlefield Systems Division and Marketing Director - Battlefield Systems Division. Prior to that he served as a career officer in the IAF, retiring with the rank of Colonel. Mr. Dvir holds a bachelor of science degree in aeronautical engineering from the Technion and a master of science degree in aeronautical engineering from the U.S. Air Force Institute of Technology at Wright Patterson Air Force Base. JACOB GADOT. Jacob Gadot was appointed Corporate Vice President - Mergers and Acquisitions in 2000 and Chief Technology Officer in 2001. He served as Vice President - Mergers and Acquisitions from 1998 to 2000 and as Vice President - Business Development from 1996 to 1998. Mr. Gadot joined Elbit Ltd. in 1983 and held various positions in EDS, including Vice President - International Marketing and head of the Airborne Division. Prior to that, he worked for Motorola Israel, after serving for ten years as an officer in the IAF. Mr. Gadot holds a bachelor of science degree in electrical engineering from the Technion. 71 RAN GALLI. Ran Galli was appointed Corporate Vice President - Major Campaigns in November 2003. From 1999 until 2003 he served as Corporate Vice President - Business Development and Marketing. Mr. Galli joined Elbit Systems in 1997 as Vice President - Business Development. Prior to that, he served as Corporate Vice President - Business Development and Marketing at Rafael, which he joined in 1990, after retiring from the IAF with the rank of Colonel. In the IAF he served as head of Research and Development, following numerous aircraft program management positions. Mr. Galli holds bachelor and master of science degrees in aeronautical engineering from the Technion. JOSEPH GASPAR. Joseph Gaspar was appointed Corporate Vice President and Chief Financial Officer in 2001. He served as Corporate Vice President - Strategy, Technology and Subsidiaries from the El-Op Merger in 2000 until 2001. From 1996 until the Merger, he held the position of Corporate Vice President, Marketing and Business Development of the El-Op Group. Mr. Gaspar joined El-Op in 1975 and held several management positions, including Vice President and General Manager of El-Op's Optronics Product Division and co-manager of an El-Op subsidiary in the United States. Mr. Gaspar holds a bachelor of science degree from the Technion in electronic engineering with advanced studies in digital signal processing and communication. ZEEV GOFER. Zeev Gofer was appointed Corporate Vice President - Business Development and Marketing in April 2003. He previously served as Corporate Vice President and as Co-General Manager - Aircraft and Helicopter Upgrades and Systems from 2000. From 1999 until 2000, he was Vice President - Aircraft Upgrades and Airborne Systems Division, having served as Division Manager since 1996. He joined Elbit Ltd. in 1982 and held various management positions, including Director of EDS' Aircraft Upgrade Division, director of a major aircraft upgrade program, director of avionics system engineering and technical manager of the LAVI avionics program. Mr. Gofer holds bachelor and master of science degrees in electronic engineering from the Technion and a master of science of management degree from the Polytechnic University of New York. DALIA GONEN. Dalia Gonen was appointed as Vice President - Human Resources in 2000. She became Director of Human Resources in 1996. Ms. Gonen joined Elbit Ltd. in 1971 and held various positions in the Human Resources Department. Ms. Gonen holds a bachelor of arts degree in sociology from Haifa University and a master of science of management degree from the Polytechnic University of New York. RAN HELLERSTEIN. Ran Hellerstein was appointed Corporate Vice President and Co-General Manager - Aircraft and Helicopter Upgrades and Systems in 2000 and became co-General Manager - Airborne and Helmet Systems in April 2003. From 1996 until 2000, he served as Vice President - Development and Engineering Division, having served as Division Manager since 1993. Mr. Hellerstein joined Elbit Ltd. in 1978 and served in various management positions, including Director and Division Manager of EDS' Engineering Division, department manager, technical manager and systems engineer. Mr. Hellerstein holds bachelor and master of science degrees in electrical engineering from the Technion. HAIM KELLERMAN. Haim Kellerman was appointed Corporate Vice President and General Manager - UAV Integrated Systems in June 2004, effective beginning in July 2004. From 2002 until his current appointment, Mr. Kellerman was Vice President - UAV Programs. Prior to that he held various senior program management positions relating to UAV, C4I and airborne programs. He joined Elbit Ltd. in 1978. Mr. Kellerman holds a bachelor of science degree in computer science from the Technion. 72 BEZHALEL MACHLIS. Bezhalel Machlis was appointed Corporate Vice President and General Manager - Land Systems and C4I in January 2004. In 2003, he served as Corporate Vice President and General Manager - Ground C4I and Battlefield Systems. From 2000 until December 2002, he served as Vice President - Battlefield and Information Systems. Mr. Machlis joined Elbit Systems in 1991 and held various management positions in the battlefield and information systems area. Prior to that, he served as an Artillery Officer in the IDF, where he holds the rank of Colonel (reserves). Mr. Machlis holds a bachelor of science degree in mechanical engineering and a bachelor of arts degree in computer science from the Technion and a MBA from Tel-Aviv University. ILAN PACHOLDER. Ilan Pacholder was appointed as Corporate Secretary and Vice

President - Finance and Capital Markets in August 2003. Mr. Pacholder served as Vice President - Finance from 2001. Mr. Pacholder joined Elbit Ltd. in 1994 and held various senior positions in the Finance Department. Prior to that he served as the Chief Financial Officer for Sanyo Industries in New York. Mr. Pacholder worked for Bank Leumi in New York for 10 years and held the position of Vice President in the international and domestic lending departments. Mr. Pacholder holds a bachelor of arts degree in accounting and economics from Queens College in New York and a MBA in finance and investments from Adelphi University. MARCO ROSENTHAL. Marco Rosenthal was appointed Corporate Vice President - Manufacturing and Purchasing in 2001, having previously served as Vice President - Operations and General Manager of the Karmiel facility since 1999. From 1996 to 1999, he served as Vice President - Material. Mr. Rosenthal joined Elbit Ltd. in 1975 and held various management positions, including Vice President - Material of EDS and Director of the Sales Department. Mr. Rosenthal holds a degree in technical engineering from the Technion and a degree in business management from Haifa University. HAIM ROUSSO. Haim Rousso was appointed Corporate Vice President and General Manager of El-Op following the Merger in 2000. Prior to that, Mr. Rousso held the position of Corporate Vice President of the El-Op Group and General Manager of El-Op. He has held various managerial positions in El-Op since 1972. Mr. Rousso holds bachelor and master of science degrees in electrical engineering from the Technion. GIDEON SHEFFER. Gideon Sheffer joined Elbit Systems in 2001 as Corporate Vice President - Strategic Planning. Prior to that he served as Acting Head of Israel's National Security Council and as National Security Advisor to former Prime Minister Ehud Barak. In 1998, he completed 32 years of service in the IDF, retiring with the rank of Major General. From 1995 to 1998, he served on the General Staff as Head of the IDF's Human Resources Branch. Prior to that, he served as Deputy Commander of the IAF. Mr. Sheffer held a number of command positions in the IAF after serving as a fighter aircraft and helicopter pilot. He is a member of the board of directors of Blue Square Ltd. and Tzarfati and Sons Ltd. Mr. Sheffer holds a bachelor's degree in Israel studies from Bar Ilan University and is a graduate of Harvard University Business School's Advanced Management Program. YORAM SHMUELY. Yoram Shmuely was appointed Corporate Vice President and General Manager - Helmet Mounted Systems in 2000 and became Co-General Manager - Airborne and Helmet Systems in April 2003. From 1998 until 2000, he was Vice President - Helmet Mounted Systems Division. From its founding in 1996 until 1998, he served as President of VSI. Mr. Shmuely joined Elbit Ltd. in 1990 and served as director of Elbit Ltd.'s Helmet Mounted Display group. He served as a fighter aircraft pilot in the IAF. Mr. Shmuely holds a bachelor of science degree in electronic engineering from the Technion. 73 TIMOTHY TAYLOR. Timothy Taylor was appointed President and Chief Executive Officer of EFW in 2000 after serving as EFW's President and General Manager since 1997. He joined EFW in 1994 and held the positions of Executive Vice President and General Manager, Vice President - Strategic Planning and Business Development and Vice President - Aircraft Systems. A more than 30-year veteran of the aerospace industry, he previously held various management and strategic business development positions with Allied Signal Inc. (now Honeywell) and GEC Marconi Avionics (now BAE Systems). A native of the United Kingdom, he became a U.S. citizen shortly after joining EFW. Mr. Taylor received an engineering degree in England COMPENSATION OF DIRECTORS AND OFFICERS The following table sets forth the aggregate compensation paid to all directors and officers of Elbit Systems as a group, other than the President, and the President individually, for the fiscal year ended December 31, 2003: Salaries, Directors' Fees Pension, Retirement Commissions and Bonuses(1) and Similar Benefits ------------------------- -------------------- All directors and officers other than the President (consisting of 26 persons) $3,572,129 $577,681 President $369,190 $85,422 ------------------------ (1) Directors, besides Joseph Ackerman, are paid in accordance with standard fees paid to External Directors in Israel, which currently includes an annual fee of $9,920 and a per meeting fee of $381. Such payments are made either directly to the director or to his or her employing company. Mr. Ackerman does not receive director fees. BOARD PRACTICES APPOINTMENT AND TERMINATION OF DIRECTORS. The current members of Elbit Systems' board of directors (Board), other than Mr. Sharony, an External Director, were appointed at the annual general meeting of shareholders held in August 2003. Mr. Sharony was appointed at a general meeting of shareholders in March 2002. 74 The employment contract of Elbit Systems' President and Chief Executive Officer Joseph Ackerman, was originally approved by Elbit Systems' shareholders in 2000, and an amendment was approved in April 2004. The agreement provides for severance payments upon termination of his employment. Mr. Ackerman's employment contract was extended through July 2006 in accordance with its terms. See below - Item 7. Major Shareholder and Related Party Transactions - Related Party Transactions - Agreements Relating to the Merger - Shareholders Agreement - Corporate Governance - President. There are no other service contracts or similar arrangements with any director that provide for benefits upon termination of directorship. See below - Item 10. Additional Information - General Provisions of Israeli Law and Related Provisions - Appointment of Directors. For information on contractual arrangements for appointment of directors resulting from the Merger, see below Item 7. Major Shareholders and Related Party Transactions - Agreements Relating to the Merger. AUDIT COMMITTEE. Dov Ninveh (chairman), Avraham Asheri, Yaacov Lifshitz and Nathan Sharony are currently members of the audit committee of the Board (the Audit Committee). The Audit Committee operates in accordance with an Audit Committee charter that provides the framework for their oversight functions consistent with Israeli and U.S. legal and regulatory requirements. See below - Item 10. Additional Information - General Provisions of Israeli Law and Related Provisions - Internal Auditor and Audit Committee; Item 16A. Audit Committee - Financial Expert and Item 16D. Exemptions from Listing Standards for Audit Committees. EMPLOYEES Most of our employees are based in Israel, and we have a significant amount of employees in the United States. The total number of employees worldwide and the number of employees in the U.S. at the end of 2003, 2002 and 2001 were as follows: Total Employees U.S. Employees -------------- ------------- 2003 5,504 1,110 2002 5,342 1,077 2001 5,040 1,040 Most of our Israeli employees have individual employment contracts. However, by law some employees receive rights under a number of general collective bargaining agreements and under Israeli employment laws. See above - Item 4. Information on the Company - Conditions in Israel - Israeli Labor Laws. Approximately 500 of El-Op's employees are covered by a collective bargaining agreement extending through the end of 2004. Union collective bargaining agreements in effect through December 2004 apply to approximately 200 of Cyclone's employees. Approximately 160 of EFW's employees in Fort Worth are subject to union collective bargaining agreements expiring in November 2005. We believe our overall relationship with our employees is satisfactory. 75 SHARE OWNERSHIP ELBIT SYSTEMS' STOCK OPTION PLANS Elbit Systems adopted employee stock option plans in 1996 (the 1996 Plan) and following the Merger with El-Op in 2000 (the Post Merger Plan). Under these Plans, stock options for our ordinary shares were granted to officers and employees of Elbit Systems and wholly-owned subsidiaries. The Plans are designed to enable us to attract and retain employees and to link their incentives to the performance of our ordinary shares. The plans were approved by our Board and shareholders and are described in prospectuses filed with the Israel Securities Authority (the ISA), and summaries were filed with the U.S. Securities and Exchange Commission (the SEC). Although the options themselves are not transferable or registered for trading, the shares underlying the options granted under the Plans were registered for trading with the SEC and the ISA. POST MERGER PLAN OPTIONS GRANTED. Under the Post Merger Plan, 5,000,000 options were authorized to be granted to approximately 800 key employees of Elbit Systems and wholly-owned subsidiaries. Approximately 4,500,000 of these options were granted to employees through a trustee in 2000. 400,000 of the options were granted to Joseph Ackerman, Elbit Systems' President and CEO. No other directors were granted options, but executive officers other than Mr. Ackerman were granted an aggregate of 582,000 options under the Post Merger Plan. Approximately 500,000 of the options under the Post Merger Plan were issued to the Plan's trustee in reserve for future grants to key employees, as determined from time to time by Elbit Systems' President. As of May 31, 2004, 169,340 of these reserve options were issued to employees. In addition, options that have lapsed or are canceled before exercise may be added to the reserve and re-granted under the Post Merger Plan. The general terms of these options are the same as those for other options granted under the Post Merger Plan. Half of the options granted to any employee under the Post Merger Plan are exercisable into one Elbit Systems ordinary share per option in consideration for the employee's payment to Elbit Systems of the exercise price. PHANTOM OPTIONS. The second half of the options granted to any employee under the Post Merger Plan is "phantom" options, similar to share appreciation rights. These options entitle the employee, on exercise of the phantom options, to receive shares in an amount corresponding to the value of the difference between the "deemed" option exercise price and the closing TASE trading price on the date before the option exercise date. For phantom options the employee pays only the par value of the shares actually received. For the impact of the accounting treatment of the phantom options, see above - Item 5. Operating Financial Review and Prospects - Management's Discussion and Analysis - Operating Results - Impact of Phantom Options. OPTION EXERCISE PRICE. The exercise price for the options granted in December 2000 is $12.32 per option. The exercise price was determined based upon a discount of 15% from the average trading price of Elbit Systems' shares on the TASE in July and August 2000. The exercise price for options granted under the future reserve is 85% of the average price of Elbit Systems' shares on the TASE for the 60 trading days prior to the specific option grant. The "deemed" option exercise price for the phantom options is the same as the option exercise price for the regular options granted at the same time under the Post Merger Plan. 76 VESTING. The options vest at the rate of 25% per year following their grant and must be exercised no later than six years after the date of grant. Termination of employment for any reason, except in special circumstances approved by Elbit Systems' President, will result in cancellation of the options that have not vested before termination of employment. Following termination of employment, unexercised options that have vested before the termination must be exercised within 90 days of termination. SHARE RIGHTS AND TAX CONSEQUENCES. Shares issued to employees as a result of exercise of the options, including phantom options, will bear rights identical to our other ordinary shares. Employees will bear all tax consequences to them resulting from the Post Merger Plan. The Israeli tax authorities have approved the Post Merger Plan's qualification under Section 102 of the Israeli Income Tax Ordinance (New Version). This enables employees who hold the options at least for two years to be exempt from Israeli tax on the gains derived from exercising the option. This also enables Elbit Systems to benefit from a deductible tax expense that amounts to the employee's above-mentioned gain. 1996 PLAN A total of 2,422,000 options were issued to employees under the 1996 Plan, as amended. Each option was exercisable into one ordinary share, and this plan did not include phantom options. All of the options under the 1996 Plan were vested and exercised in 2002. 77 ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS. MAJOR SHAREHOLDERS PERCENTAGES Elbit Systems had, as of May 31, 2004, 40,244,029 ordinary shares outstanding. (This amount includes 408,921 shares held by us and our subsidiaries as treasury shares). The following table sets forth specific information as of May 31, 2004, to the best of our knowledge, concerning: o beneficial ownership of more than 5% of our outstanding ordinary shares; and o the number of ordinary shares beneficially owned by all of our officers and directors as a group. Federmann Enterprises Ltd. 12,100,000 30.06% 99 Hayarkon Street Tel-Aviv, Israel(1)(4) Heris Aktiengesellschaft 3,836,458(2) 9.53% c/o 99 Hayarkon Street Tel-Aviv, Israel Elron Electronic Industries Ltd. 7,815,448 19.42% 3 Azrieli Center, 42nd Floor Tel-Aviv, Israel(3)(4) Bank Hapoalim Group 2,247,604 5.58% Tel-Aviv, Israel(5) Bank Leumi Group Tel-Aviv, Israel (5) 2,190,827 5.44% All officers and directors as a group (27 persons) 338,623 (6) 0.84% --------------------------- (1) Federmann Enterprises Ltd. (FEL) owns the shares of Elbit Systems directly and indirectly through Heris Aktiengesellschaft (Heris) which is controlled by FEL. FEL is controlled by Beit Federmann Ltd. (BFL). BFL is controlled by Beit Bella Ltd. (BBL) and Beit Yekutiel Ltd. (BYL). Michael Federmann is the controlling shareholder of BBL and BYL. He is also the Chairman of Elbit Systems' Board and the Chairman of the Board and the Chief Executive Officer of FEL. Therefore, Mr. Federmann controls, directly and indirectly, the vote of the shares owned by Heris and FEL. 78 (2) The amount of shares owned by Heris is included in the amount of shares held by FEL as set forth in footnote (1) above. (3) Elron Electronic Industries Ltd. (Elron) is a multinational, high technology operational holding company whose business is conducted through a group of high technology operating companies. The principal shareholders of Elron are Discount Investment Corporation Ltd. (DIC), mutual and/or provident funds managed by Bank Leumi (the Bank Leumi Group), mutual and/or provident funds managed by Bank Hapoalim (the Bank Hapoalim Group) and the Insurance Fund headed by Clal Insurance Enterprises Holdings Limited (Clal). As of May 31, 2004, DIC held approximately 38.5% of the voting power of Elron, and the Bank Leumi Group, the Bank Hapoalim Group and Clal held approximately 8.3%, 6.4% and 2.4%, respectively, of the voting power of Elron. IDB Holding Corporation Ltd. (IDBH) is the parent of IDB Development Corporation Ltd. (IDBD), which, in turn, is the parent of DIC and Clal. IDBH, IDBD, DIC and Clal are public companies traded on the TASE. Approximately 51.7% of the outstanding share capital of IDBH is owned by a group comprised of: (i) Ganden Investments I.D.B. Ltd. (Ganden), a private Israeli company controlled by Nochi Dankner and his sister, Shelly Dankner-Bergman, which holds 31.02% of the equity of and voting power in IDBH; (ii) Manor Investments - IDB Ltd. (Manor), a private Israeli company controlled by Ruth Manor, which holds 10.34% of the equity of and voting power in IDBH; and (iii) Avraham Livnat Investments (2002) Ltd. (Livnat), a private Israeli company controlled by Avraham Livnat, which holds 10.34% of the equity of and voting power in IDBH. Ganden, Manor and Livnat, owning in the aggregate approximately 51.7% of the equity of and voting power in IDBH, entered into a shareholders agreement relating, among other things, to their joint control of IDBH, the term of which is until May 19, 2023. Shelly Dankner-Bergman holds approximately 4.9% of the equity and voting power in IDBH. Nochi Dankner is Chairman of IDBH, IDBD and DIC and a director of Clal. Shelly Dankner-Bergman and Zvi Livnat (the son of Avraham Livnat) are directors of each of IDBH, IDBD and DIC. Shai Livnat (the son of Avraham Livnat) is a director of IDBD and Clal. Isaac Manor (the husband of Ruth Manor) is a director of IDBH, IDBD, DIC and Clal, and Dori Manor (the son of Isaac and Ruth Manor) is a director of IDBH, IDBD, DIC and Elron. Doron Birger, a director of Elbit Systems, is the President and CEO of Elron. Ami Erel, Avraham Asheri and Avi Fischer, directors of Elbit Systems, are also directors of Elron. (4) FEL and Heris (collectively the Federmann Group) and Elron may be deemed for purposes of U.S. securities laws to be joint owners of the aggregate ordinary shares of Elbit Systems beneficially owned by them by virtue of a shareholders agreement dated December 19, 1999 between the members of the Federmann Group and Elron, which provides, among other things, for their coordinated voting at Elbit Systems' shareholder meetings and for their equal representation on Elbit Systems' Board of Directors. (5) The holdings in Elbit Systems' shares by the Bank Hapoalim Group and the Bank Leumi Group are divided among several entities, mainly mutual and/or provident funds. 79 (6) This amount does not include any shares that may be deemed to be beneficially owned by Michael Federmann as described in footnote (1) above. The amount includes 81,508 shares underlying options that are currently exercisable or that will become exercisable within 60 days of May 31, 2004. A portion of the underlying options are "phantom options" that have been calculated based on Elbit Systems' May 31, 2004 share closing price of $18.72. RIGHTS IN SHARES, SIGNIFICANT CHANGES IN SHAREHOLDERS AND CONTROLLING SHAREHOLDERS Except to the extent provided in the Shareholders Agreement (the Shareholders Agreement) described below in "Related Party Transactions - Agreements Relating to the Merger", Elbit Systems' major shareholders have the same rights as other holders of Elbit Systems' ordinary shares. The only significant change in shareholdings by major shareholders in the last three years was the change resulting from the Merger in the holdings of Elron and the Federmann Group. As a result of the Merger in 2000, Elron's shareholding percentage decreased from approximately 33% to approximately 23%, and the Federmann Group received approximately 32% of Elbit Systems shares. In addition, Elron sold 380,000 shares in 2001 and 380,000 shares in 2002. Elron and the Federmann Group may be considered under Israeli law as controlling shareholders of Elbit Systems due to the Shareholders Agreement. We are not aware of any other arrangement, including by way of a shareholder agreement or registration rights agreement, that in the future may lead to a change in control of Elbit Systems. Except as provided in the Shareholders Agreement regarding appointment of directors, the Chairman of the Board and the President, no appointment of the President or a director is made as a result of a related party transaction. Also, there are no outstanding loans by Elbit Systems or its subsidiaries to such persons. RELATED PARTY TRANSACTIONS AGREEMENTS RELATING TO THE MERGER There are three main agreements relating to the Merger: - A merger agreement dated December 19, 1999 (the Merger Agreement) among Elbit Systems, El-Op and the Federmann Group. - The Shareholders Agreement dated December 19, 1999, between Elron and the Federmann Group. - A registration rights agreement, effective on July 5, 2000, the closing date of the Merger (the Registration Rights Agreement) among Elbit Systems, Elron and the Federmann Group. The following is a summary of major provisions of those agreements. 80 MERGER AGREEMENT NATURE OF THE MERGER AND CONSIDERATION. The Merger was accomplished through a statutory merger under Israeli law of El-Op into Elbit Systems followed immediately by a spin-off of part of the merged assets and liabilities into a wholly-owned subsidiary of Elbit Systems, which assumed El-Op's name. In consideration for the Merger, the Federmann Group, the principal shareholders of El-Op before the Merger, was issued 12,100,000 new Elbit Systems ordinary shares. REPRESENTATIONS AND ADJUSTMENTS TO THE MERGER CONSIDERATION. Elbit Systems and El-Op made representations regarding their business and capital structure. The Federmann Group made representations regarding ownership of its shares in El-Op. If any of the representations were found to be incorrect, an adjustment would be made to the number of Elbit Systems' shares issued to the Federmann Group under the Merger. The time period for such adjustment expired in March 2003, and no adjustments were made. TAXES AND EXPENSES. Each party bears any tax liability that may be imposed on it relating to the Merger Agreement. Elbit Systems paid the Israeli stamp tax payable for the issuance of ordinary shares. The parties share any other Israeli stamp tax payable due to the Merger Agreement. The parties agreed to comply with all the conditions for tax exemption in accordance with the Israeli Income Tax Ordinance or as determined by the Israeli Income Tax Commissioner. Among other things, Elbit Systems agreed not to issue new shares if, as a result of the issuance, the Federmann Group or any of the units comprising it, will be charged with tax. Under the Israeli Income Tax Ordinance, subject to conditions imposed by applicable law and regulations, due to the tax exemption granted for the Merger, Elbit Systems generally was restricted for a period of two years following the Merger from issuing new shares in excess of 25% of the amount of its outstanding shares existing prior to the Merger. However, this restriction did not apply to a public offering or shares issued under a stock option plan. Each party to the Merger Agreement agreed to pay any taxes and expenses that are imposed on it under any provisions of law and/or that it incurs pursuant to the Merger Agreement. ARBITRATION. The parties agreed to submit to arbitration any dispute that arises between them regarding the Merger Agreement. SHAREHOLDERS AGREEMENT CORPORATE

GOVERNANCE. Elron and the Federmann Group agreed that following the Merger, so long as each holds at least 15% of Elbit Systems' issued share capital, the following applies. BOARD MEMBERS The parties agreed to vote to cause Elbit Systems' Board to have 11 members, consisting of four directors nominated by Elron, four directors nominated by the Federmann Group, the two External Directors and the President of Elbit Systems. In April 2004, Elbit Systems' shareholders approved an amendment to the Articles of Incorporation reducing the normal number of directors to ten and removing the requirement that the President be a director. All Board committees are represented equally by the Board nominees of Elron and the Federmann Group. Should the holdings of Elbit Systems' issued share capital of only one of the parties fall below 15%, but not below 5%, and provided the other party holds at least 15%, the number of directors that party will have the right to nominate to the Board will be reduced proportionally. 81 The other party will have the right to nominate all other members of the Board and to appoint the Chairman of the Board and the President and the Chief Executive Officer. EXTERNAL DIRECTORS. The Federmann Group has the right to nominate a candidate to replace the first of the two External Directors who vacates his appointment. Elron has the right to nominate a candidate to replace the second of the two External Directors who vacates his appointment. This arrangement will continue as long as Elbit Systems is required to have External Directors. PRESIDENT AS A BOARD MEMBER. As described in "Board Members" above, in April 2004 our shareholders approved an amendment to our Articles of Incorporation, removing the requirement, established in the Shareholders' Agreement, that the President serve as director. The President is entitled to participate in all Board meetings. BOARD CHAIRMAN. The Chairman of the Board is elected by the shareholders from among the Board members. The Federmann Group nominates a candidate for the office of Chairman of the Board after it has consulted with Elron. Michael Federmann was elected as Chairman beginning on the Merger closing date. PRESIDENT. Joseph Ackerman continued as Elbit Systems' President and Chief Executive Officer for a period of three years from the Merger closing date, as specified in his employment agreement. The agreement was automatically extended for another three-year period according to its terms. Following termination of Mr. Ackerman's employment, Elron will nominate a candidate for the office of President and Chief Executive Officer, after consulting with the Federmann Group. The President and Chief Executive Officer will be elected by the Board, and his or her appointment is subject to shareholder approval. VOTES OF THE BOARD. Except as provided otherwise in our Articles of Association, resolutions of the Board are determined by a simple majority of the members participating in the vote. No member of the Board, including the Chairman, has more than one vote. VOTES AT SHAREHOLDERS MEETINGS. The parties coordinate in advance on how they will vote their shares at any of our shareholders meetings. Except as provided above, the parties will vote their shares against any proposed resolution at any shareholders meeting, unless they agree in writing in advance to vote in favor. RESTRICTIONS ON SALES AND PURCHASES OF ELBIT SYSTEMS SHARES Following the Merger, as long as one of the parties holds at least 15%, and the other party at least 5%, of Elbit Systems' issued share capital, no transfer of Elbit Systems' shares by either party will be valid unless made in accordance with the following: o During the period beginning on January 1, 2003 and ending on December 31, 2004, neither party will transfer shares of Elbit Systems if, as a result of the transfer, the transferring party's holdings fall below 15% of Elbit Systems' issued share capital, unless: - shares constituting at least 15% of Elbit Systems' issued share capital are transferred; and 82 - all of the obligations and rights of the transferring party under the Shareholders Agreement have been assigned and transferred to the buyer, with the buyer's assumption of all such obligations, and written notice to this effect signed by both the transferor and the buyer has been given to the other party before the transfer. o After January 1, 2005, no party will transfer, as part of a single transaction, 15% or more of Elbit Systems' issued share capital unless all of the obligations and rights of the transferring party under the Shareholders Agreement have been assigned and transferred to the buyer, with the buyer's assumption of all such obligations, and written notice to this effect signed by both the transferor and the buyer has been given to the other party to the Shareholders Agreement before the transfer. FIRST REFUSAL AND TAG ALONG RIGHTS The Shareholders Agreement provides for rights of first refusal if a party wants to transfer Elbit Systems shares to a third party buyer. The party intending to sell its Elbit Systems shares must first offer them to the other party on the same terms offered by the buyer. The Shareholders Agreement also provides for tag along rights if a party wants to transfer shares to a third party buyer. The party wishing to sell its shares must enable the other party to participate in the sale to a third party buyer, unless the selling party wishes to: (a) sell at least 15% of Elbit Systems' issued share capital, and (b) the third party buyer assumes the obligations of the selling party under the Shareholders Agreement. The above provisions do not apply to any transfer by a party to a person or entity that it controls or that controls such party or that is under common control with such party. The right of first refusal and tag along rights will also apply to any transfer of shares of Federmann Enterprises or Heris, respectively, if Elbit Systems shares held by such entity at any time constitute in excess of 90% of the total assets of that entity and as a result of such transfer of shares, Federmann Enterprises or Heris, as applicable, ceases to be under the control of the Federmann family. PARTICIPATION RIGHTS. The Shareholders Agreement also provides for purchase participation rights. If a party purchases Elbit Systems shares, the other party may participate in this purchase on the same terms as the first party on a pro-rata basis, based on the number of Elbit Systems shares then held by the parties. However, this participation right shall not apply to any purchases made by Elron until Elron's share holdings in Elbit Systems equal those of the Federmann Group. PERMITTED SALES. Despite the above restrictions on sales of Elbit Systems shares, each party may sell shares on the TASE in quantities not more, in any calendar quarter, than 1% of Elbit Systems' issued share capital. TERMINATION OF THE AGREEMENT. The Shareholders Agreement will remain in effect until the earlier of: (a) December 18, 2014; or 83 (b) the date any party's holdings fall below 5% of Elbit Systems' issued share capital, provided that all the rights and obligations of that party under the Shareholders Agreement have not been previously transferred or transferred concurrently with such reduction to a new party, in which case the Shareholders Agreement will not terminate but will bind the new party. REGISTRATION RIGHTS AGREEMENT DEMAND REGISTRATION. Elron and the Federmann Group each may twice require Elbit Systems to register their ordinary shares for sale in the United States. No shareholder may demand registration of ordinary shares less than 180 days following the effective date of any registration statement previously filed by Elbit Systems under a demand registration. Elbit Systems has the right to delay filing of a registration statement in specific circumstances. PIGGYBACK REGISTRATION. Elron and the Federmann Group have an unlimited number of "piggyback" registration rights. This means that any time Elbit Systems proposes to file a registration statement in connection with any public offering of any ordinary shares in the United States, whether for the account of Elbit Systems or any Elbit Systems shareholder, Elron and the Federmann Group each may require Elbit Systems to include its ordinary shares in that offering. TERMINATION OF REGISTRATION RIGHTS. The respective registration rights of Elron and the Federmann Group terminate if such shareholder and its affiliates collectively cease to own at least 5% of the then issued and outstanding Elbit Systems ordinary shares or such shares of any successor corporation. EXPENSES AND INDEMNITY. Other than fees and disbursements of counsel to the shareholders, Elbit Systems agreed to pay all expenses that result from the registration of ordinary shares under the Registration Rights Agreement, all underwriting fees, commissions and discounts connected with the sale of any ordinary shares and any transfer taxes incurred in such sale. Elbit Systems also agreed to indemnify Elron and the Federmann Group against liabilities that may result from misrepresentations or omissions in any registration statement filed under the Registration Rights Agreement or any violation of U.S. federal or state securities laws in connection with any such registration, other than those liabilities caused by any act or omission of such shareholder. TRANSACTIONS WITH ELRON AND AFFILIATED COMPANIES Elbit Systems and RDC, an affiliated company of Elron, are joint owners of Starling. See above - Item 4. Information on the Company - Technology Spin-Offs - Starling. DIC, a controlling shareholder of Elron, is a controlling shareholder of Gav Yam Ltd. (Gav Yam), which in turn is a controlling shareholder of Matam - Advanced Technology Center Ltd. (Matam). Elbit Systems entered into agreements with both Gav Yam and Matam in connection with the construction of Elbit Systems' new building in Haifa. See above - Item 4. Information on the Company - Property, Plant and Equipment. These agreements were approved at a general meeting of Elbit Systems' shareholders. 84 Under a lease agreement entered into in 1996, Elbit Systems currently leases from Elbit Ltd. approximately 170,000 square feet of office and manufacturing space in Karmiel, Israel. Elbit Ltd. is a wholly-owned subsidiary of Elron. The lease expires in October 2006 and may be terminated earlier by Elbit Systems upon twelve months' prior written notice. The monthly rent is an amount in NIS equal to approximately $0.598 per square foot linked to the U.S. dollar and the U.S. CPI, payable quarterly at the beginning of each quarter. In the event that the area leased is substantially reduced, the monthly rent will be determined by the parties. In the ordinary course of business, some subsidiaries and affiliates of Elbit Systems engage in business activities with each other on terms that we believe are comparable to those negotiated between third parties on an arms-length basis. TRANSACTIONS WITH OFFICERS AND DIRECTORS Some members of Elbit Systems' Board are also directors of companies in the Federmann Group or Elron. Therefore, in the event of an issue or transaction between Elbit Systems and any of those companies, those individuals who are affiliated with both of the applicable companies will be excluded from any decisions concerning such issue or transaction. Transactions with officers, directors, key employees and affiliates may require authorization in accordance with the requirements of the Companies Law. See below - Item 10. Additional

Information - Approval of Certain Transactions. For information on the grant of options in Elbit Systems' shares to officers and directors, see above - Item 6. Directors, Senior Management and Employees - Share Ownership - Elbit Systems' Stock Option Plans. 85 ITEM 8. FINANCIAL INFORMATION. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION See Consolidated Financial Statements attached to this Form 20-F. LEGAL PROCEEDINGS Elbit Systems and our subsidiaries are involved in legal proceedings from time to time. Based on the advice of our legal counsel, management believes such current proceedings will not have a material adverse effect on the financial position or results of operations of Elbit Systems. DIVIDEND DISTRIBUTIONS Elbit Systems does not have a declared dividend policy. Our Articles of Association provide that the Board may approve dividend payments to shareholders out of surplus earnings as permitted by applicable law. To date we have consistently paid a quarterly dividend to our shareholders. Our dividend payments for the last three full fiscal years were as follows: 2001 $0.32 per share 2002 $0.34 per share 2003 $0.40 per share 86 ITEM 9. OFFER AND LISTING. SHARE LISTINGS AND TRADING PRICES Elbit Systems' ordinary shares are quoted on Nasdaq under the symbol "ESLT" and are also listed on the TASE. The high and low sale prices for our ordinary shares for the five most recent full financial years are: NASDAQ TASE (1) HIGH LOW HIGH LOW ---- --- ---- --- 1999 $18.47 $12.38 $18.41 $12.17 2000 $19.38 $11.28 $19.18 $11.75 2001 $19.37 $13.72 $18.77 $15.53 2002 $19.31 $14.98 $18.92 $14.32 2003 $20.00 $14.51 $20.08 $14.99 The high and low quarterly sale prices for our ordinary shares for the two most recent full financial years and the first two subsequent quarters are: NASDAQ TASE(1) ------ ------- HIGH LOW HIGH LOW ---- --- ---- --- 2002 First Quarter $19.31 $17.30 $18.28 $17.50 Second Quarter $17.79 $15.00 $17.06 $15.20 Third Quarter $17.11 $15.36 $16.80 $15.08 Fourth Quarter $17.39 $14.69 $17.24 $14.43 2003 First Quarter $16.84 $14.51 $17.00 $14.77 Second Quarter $20.00 $16.60 $20.08 $16.39 Third Quarter $19.53 $16.64 $19.48 $16.43 Fourth Quarter $18.88 $15.36 $18.72 $14.99 2004 First Quarter $19.99 $17.85 $20.55 $18.01 Second Quarter (through May 31, 2004) $19.40 $17.88 $19.47 $17.80 87 The monthly high and low sale prices of our ordinary shares for the most recent six months are: NASDAQ TASE (1) HIGH LOW HIGH LOW ---- --- ---- --- December 2003 $18.30 $15.36 $18.06 $14.99 January 2004 $19.97 $18.03 $20.55 $18.01 February 2004 $19.99 $18.17 $19.98 $18.11 March 2004 $19.25 $17.85 $19.31 $17.62 April 2004 $19.40 $18.14 $19.47 $17.80 May 2004 $19.21 $17.88 $19.25 $18.05 ------------- (1) The closing prices of our ordinary shares on the TASE have been translated into U.S. dollars using the daily representative rate of exchange of the NIS to the U.S. dollar as published by the Bank of Israel. As of May 31, 2004, approximately 4.08% of our outstanding ordinary shares was held in the United States by approximately 236 holders registered on the books of our transfer agent. 88 ITEM 10. ADDITIONAL INFORMATION. GENERAL PROVISIONS OF ISRAELI LAW AND RELATED PROVISIONS OF ARTICLES OF ASSOCIATION ISRAELI COMPANIES LAW AND REVISED ARTICLES OF ASSOCIATION. The Israel Companies Law - 1999 (the Companies Law) became effective in 2000. It replaced the Israeli Companies Ordinance as the basic corporation law governing Israeli publicly and privately held companies. The Companies Law also mandates specific provisions be included in an Israeli company's articles of association. In 2000, following receipt of the required shareholder approval, Elbit Systems adopted Restated Articles of Association (the Articles of Association), which incorporate, among other provisions, revisions mandated by the Companies Law and the agreements relating to the Merger. See above - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Merger. APPOINTMENT OF DIRECTORS. Elbit Systems' directors are appointed by the shareholders at the annual general shareholders meeting. They hold office until the next annual general shareholders meeting, which is held at least once every calendar year but not more than 15 months after the previous general shareholders meeting. Between annual general shareholders meetings the Board may appoint new directors to fill vacancies, however new External Directors must be elected at a general shareholders meeting as described in "External Directors" below. Appointment of directors is also subject to the terms of the Merger Agreement and the Shareholders' Agreement relating to the Merger. See above - Item 7. Major Shareholders and Related Party Transactions - Related Party Transactions - Agreements Relating to the Merger. Under these agreements Elron and the Federmann Group each appoints four members to the Board. The Chairman of the Board is appointed from the Federmann Group nominees. The Articles of Association authorizes a maximum of 17 and a minimum of five directors. However, unless otherwise approved by the Board or a general shareholders meeting or during an interim period following a director's resignation, there are 10 directors, including two External Directors as described in "External Directors" below. SUBSTITUTE DIRECTORS. The Articles of Association provide that any director may appoint another person to serve as a substitute director. A substitute director must be qualified under the Companies Law to serve as a substitute director. If his or her appointment is for more than one meeting it will be subject to the approval of the Board. Such person may not act as a substitute director for more than one director at the same time. The same rules, including compensation, will apply to a substitute director as to the director who appointed him or her, and the substitute director may participate in Board and Board committee meetings in the same manner as the appointing director. Subject to the Companies Law, a director who has appointed a substitute director may revoke the appointment at any time. In addition, the office of a substitute director will be vacated at any time that the office of the director who appointed the substitute is vacated for any reason. Any appointment or revocation of the appointment of a substitute director will be made by notice in writing to the substitute director and Elbit Systems. The appointment or revocation, as the case may be, will become effective on the later of the date of receipt of the above notice or the date fixed in the notice. EXTERNAL DIRECTORS. Under the Companies Law publicly held Israeli companies are required to appoint two "External Directors". Among other requirements, External Directors must be unaffiliated 89 with Elbit Systems and our controlling shareholders. External Directors serve for a three-year term that may be extended for an additional three-year term. Any committee of the Board must include at least one External Director. Nathan Sharony and Yaacov Lifshitz currently serve as an External Directors of Elbit Systems, and their terms of office end in March 2005 and July 2006, respectively. INTERNAL AUDITOR AND AUDIT COMMITTEE. Publicly held Israeli companies are required to appoint an internal auditor. The main role of the internal auditor is to examine whether the company's activities comply with the law, integrity and orderly business procedure. Publicly held companies are also required to establish an audit committee of the Board of Directors. The audit committee must consist of at least three directors qualified under the Companies Law, including all External Directors. The audit committee and the internal auditor operate in accordance with an audit committee charter that provides the framework for their functions. See above - Item 6. Directors, Senior Management and Employees - Board Practices - Audit Committee. OFFICE HOLDERS The Companies Law specifies the duty of care and fiduciary duties that an "Office Holder" owes to a company. An Office Holder is defined as a director, general manager, chief business manager, executive vice president, vice president or any other person who fulfills these functions without regard to that person's title or other manager directly under the general manager. Each person listed above in Item 6. Directors and Executive Officers is an Office Holder of Elbit Systems. Under the Companies Law, an Office Holder's fiduciary duty includes avoiding any conflict of interest between the Officer Holder's position in the company and his or her personal affairs. The fiduciary duty also includes avoiding any competition with the company and avoiding exploiting any business opportunity of the company in order to receive personal advantage for the Office Holder or others. Also, the Office Holder is required to disclose to the company any information or documents relating to the company's affairs that the Officer Holder has received due to his or her position as an Office Holder. Under the Companies Law voting agreements among directors are considered a breach of fiduciary duty. In addition, all compensation arrangements between the company and Office Holders who are not directors require approval of the Board. APPROVAL OF CERTAIN TRANSACTIONS APPROVAL PROCEDURES. The Companies Law requires that certain transactions, actions and arrangements, mainly with related parties, be approved as provided for in the Companies Law and in a company's articles of association and in some cases by the audit committee and by the board of directors. Sometimes shareholder approval is also required. PERSONAL INTEREST AND EXTRAORDINARY TRANSACTIONS. The Companies Law requires that an Office Holder or a controlling shareholder of a company immediately disclose (and no later than the first board meeting the transaction is discussed) any "Personal Interest" that he or she may have and all related material information known to him or her, in connection with any existing or proposed transaction by the company. An Office Holder with a personal interest in any such matter that is brought for approval of the audit committee or board of directors may not be present at the meeting where the matter is being approved and may not vote on the matter. "Personal Interest" also includes any interest held by the Office Holder's spouse, siblings, parents, grandparents, descendants, spouse's descendants and the spouses of any 90 of them. It also includes an interest by any corporation in which the Office Holder or his or her relative is a 5% or greater shareholder, director or general manager or in which he or she has the right to appoint at least one director or the general manager. An "extraordinary transaction" is other than in the ordinary course of business, other than on market terms, or is likely to have a material impact on the company's profitability, assets or liabilities. APPROVAL OF TRANSACTIONS The Companies Law requires approval by both the Audit Committee and the Board for the following transactions: (1) extraordinary transactions with an Office Holder or in which an Office Holder has a Personal Interest; (2) material actions or arrangements that may otherwise be considered a breach of fiduciary duty of an Office Holder; (3) terms of service of directors, including the grant of indemnification, exemption or insurance and terms of employment of directors in other roles; or (4) exemption from insurance and indemnification of Office Holders. Matters referred to in (3) may also require shareholder approval, including, where applicable, a specified percentage of non-interested shareholders. Extraordinary transactions with controlling shareholders or extraordinary transactions with another person in which the controlling shareholder has a personal interest require approval by the audit committee, board of directors and general meeting of shareholders by a special majority as provided in the Companies Law. INSURANCE AND INDEMNIFICATION OF DIRECTORS AND OFFICERS INSURANCE AND INDEMNIFICATION UNDER THE COMPANIES LAW The Companies Law permits a company to obtain an insurance policy covering liabilities of Office Holders resulting from a breach of the Office Holder's duty of care to the company or to another person. This includes liabilities from the breach of his or her fiduciary duty to the company, to the extent that the Office Holder acted in good faith and had reasonable cause to believe that the act would not prejudice the interests of the company. It also covers monetary liabilities charged against an Office Holder while serving the company. The Companies Law also allows a company to indemnify an Office Holder, in advance or retroactively, in connection with his or her activities as an Office Holder. This includes indemnification for monetary liability incurred under a judgment, including a settlement or arbitration decision approved by a court, in an action brought against the Office Holder by a third party. It also includes reasonable litigation expenses, including attorneys' fees, incurred in an action brought against him or her by, or on 91 behalf of, the company or others, or as a result of a criminal charge of which he or she was acquitted or for a criminal charge for which he or she may be found guilty but that does not involve criminal intent. A company may not indemnify an Office Holder or enter into an insurance contract that would provide coverage for any monetary liability incurred as a result of the following: (1) a breach of fiduciary duty, except for a breach of a fiduciary duty to the company while acting in good faith and having reasonable cause to assume that such act would not prejudice the interests of the company; (2) a willful breach of the duty of care or reckless disregard for the circumstances or to the consequences of a breach of the duty of care; (3) an act done with the intent to unlawfully realize a personal gain; or (4) a fine or monetary penalty imposed for an offense. INSURANCE AND INDEMNIFICATION UNDER THE ARTICLES OF ASSOCIATION Elbit Systems' Articles of Association allows for directors and officers liability insurance, subject to the provisions of the Companies Law. This insurance may cover: (1) a breach of his or her duty of care to Elbit Systems or to another person; (2) a breach of his or her fiduciary duty to Elbit Systems, provided that the director or officer acted in good faith and had reasonable cause to assume that his or her act would not harm the interests of Elbit Systems; or (3) any other event for which insurance of a director or officer is permitted. In addition, Elbit Systems' Articles of Association permit indemnification, retroactively or in advance, of a director or officer against: (1) a monetary liability imposed on the director of officer in favor of a third party under a judgment, including a judgment by way of compromise or a judgment of an arbitrator approved by a court; (2) reasonable expenses of the proceedings, including lawyers fees, expended by the director or officer or imposed on him or her by the court for: (a) proceedings issued against him or her by or on Elbit Systems' behalf or by a third party; (b) criminal proceedings from which the director or officer was acquitted; or (c) criminal proceedings in which he or she was convicted but that do not require proof of criminal intent; or 92 (3) any other liability or expense for which it is or may be permissible to indemnify a director or an officer. However, any indemnification so granted by Elbit Systems may not exceed 25% of Elbit Systems' consolidated equity as reflected in our last consolidated annual financial statements published prior to the payment of such indemnification. The Articles of Association permit the grant of similar indemnification to any person acting as a director or officer of another company in which Elbit Systems is directly or indirectly a shareholder or has any interest. Elbit Systems' shareholders approved the grant to members of our Board of indemnification letters reflecting the above conditions and limitations. Similar letters were also approved by the Board for grant to officers of Elbit Systems. In April 2004, a general meeting of Elbit Systems' shareholders approved a framework resolution that allows Elbit Systems to purchase directors and officers (D&O) liability insurance that meets the framework resolution's terms. The framework resolution covers a five-year period beginning at the end of the term of the current D&O insurance policy in August 2004, and allows for an aggregate increase of insurance coverage of up to $45,000,000 (from the current level of $30,000,000) for any year covered by the policy. The framework resolution also allows for an increase of up to 25% per year in the D&O insurance premium up to a maximum aggregate of 125% of the current annual premium ($660,000). The Audit Committee and the Board must approve that any purchase of D&O insurance falls within the terms of the framework resolution. MATERIAL CONTRACTS Elbit Systems has not entered into material contracts since June 1, 2002, other than in the ordinary course of business. EXCHANGE

CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS Non-residents of Israel may freely hold and trade our ordinary shares under general and specific permits issued under the Israeli Currency Control Law, 1978. Our Memorandum of Association and Articles of Association do not restrict the ownership of ordinary shares by non-residents of Israel. Neither the Memorandum of Association and Articles of Association nor Israeli law restrict the voting rights of non-residents. Under the general permit given through the Israeli Currency Control Law, 1978, non-residents of Israel who buy our ordinary shares inside or outside of Israel with any foreign currency are able to receive a number of types of distributions in freely repatriable U.S. dollars or specified other currencies. These distributions include dividends, proceeds from the sale of shares and any amounts payable on the dissolution, liquidation or winding-up of Elbit Systems. 93 In the last several years, the Government of Israel liberalized its policies regarding exchange controls and investments in Israel and abroad. TAXATION GENERAL The following is a summary of some aspects of the current tax law applicable to companies in Israel, with special reference to its effect on Elbit Systems and our Israeli subsidiaries. The following also contains a discussion of specified Israeli tax consequences to our shareholders and government programs from which we and some of our Israeli subsidiaries benefit. To the extent that the discussion is based on tax legislation that has not been subject to judicial or administrative interpretation, there can be no assurance that the views expressed in the discussion will be accepted by the tax authorities in question. In 2002, the Israeli Parliament approved a law enacting extensive changes to Israel's tax law (the Tax Reform Legislation) generally effective January 1, 2003. Among the key provisions of the Tax Reform Legislation are: (i) changes which may result in the imposition of taxes on dividends and interest received by an Israeli company from its foreign subsidiaries; and (ii) the introduction of the "controlled foreign corporation" concept according to which an Israeli company may become subject to Israeli taxes on certain income of a non-Israeli subsidiary if the subsidiary's primary source of income is passive income (such as interest, dividends, royalties, rental income or capital gains). An Israeli company that is subject to Israeli taxes on the income of its non-Israeli subsidiaries will receive a credit for income taxes paid or withheld or that will be paid or withheld by the subsidiary in its country of residence according to the conditions determined in the Israeli Tax Ordinance. The discussion is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations. EFFECTIVE CORPORATE TAX RATE. Generally, Israeli corporations are subject to a 36% "Company Tax" (which rate maybe reduced to 35% in 2004). Elbit Systems' income tax liability in Israel is based on our unconsolidated earnings and such earnings of our Israeli-based subsidiaries. It is determined in NIS and not in U.S. dollars. Tax liability of non-Israeli subsidiaries is determined according to the law of their countries of residence. As a result, the tax provision in Elbit Systems' consolidated financial statements does not directly relate to income reported on these statements. A portion of Elbit Systems' Israeli operations have been granted "Approved Enterprise" status, as described under "Investment Law" below. These operations are subject to taxation at reduced rates applicable to those types of enterprises. In addition, they are permitted special adjustments in computing taxable income under the Income Tax Law (Inflationary Adjustments), 1985. INDUSTRY ENCOURAGEMENT. Under the Law for the Encouragement of Industry (Taxes), 1969, a company qualifies as an "Industrial Company" if it is resident in Israel and at least 90% of its income in a given tax year, with some exceptions, comes from "Industrial Enterprises" owned by that company. An 94 Industrial Enterprise is defined as an enterprise whose primary activity in a particular tax year is industrial manufacturing activity. We believe Elbit Systems qualifies as an Industrial Company. The principal benefits of this status are amortization of the cost of know-how and patents, under certain interpretations, deduction of expenses incurred in connection with a public issuance of securities over a three-year period and an election under certain conditions to file a consolidated tax return with additional related Israeli Industrial Companies. INVESTMENT LAW The Israeli Law for the Encouragement of Capital Investments, 1959 provides that a capital investment in eligible facilities approved by the Israel Investment Center may be designated as an "Approved Enterprise". Each approval for an Approved Enterprise relates to a specific investment program. The approvals specify both the program's financial scope, including its capital resources, and its physical characteristics, such as the equipment to be purchased and used under the program. An Approved Enterprise is entitled to several benefits, including Israeli Government cash grants and tax benefits. The applicable tax benefits relate only to taxable profits attributable to the specific Approved Enterprise. As of December 31, 2003, Elbit Systems had four and El-Op had four active approved programs eligible for tax benefits. These programs will expire during the years 2004 to 2012. CAPITAL GAINS TO A COMPANY Israeli law imposes a capital gains tax on the sale of capital assets. The law distinguishes between the real capital gain and the inflationary surplus. The inflationary surplus accumulated until

December 31, 1993 is taxed at a rate of 10%. Inflationary surplus accumulated from and after December 31, 1993 is exempt from any capital gains tax. The real capital gain was taxed until December 31, 2002 at a rate of 36% for corporations. Effective January 1, 2003, the real capital gains tax rate imposed on the sale of capital assets acquired after that date has been reduced to 25%. Capital gains accrued from assets acquired before that date are subject to a blended tax rate based on the relative periods of time before and after the date that the asset was held as well as accumulated depreciation. CAPITAL GAINS TO A SHAREHOLDER Effective January 1, 2003, so long as our ordinary shares are listed on a stock exchange the sale of these shares is subject to a blended tax in which the portion of the gain accrued until December 31, 2002 is exempt from Israeli capital gains tax, and the portion of the real gain accrued from January 1, 2003 until the date of sale is subject to a 15% tax. The real gain is based on the difference between the adjusted average value of the shares during the last three trading days before January 1, 2003 (or the adjusted original cost if it is higher than the adjusted average value) and the value of the shares at the date of sale. In the later case, the capital loss that might be set off is the difference between the adjusted average value and the value of the shares at the date of sale. In addition, since Elbit Systems ordinary shares are traded on the TASE and Nasdaq, gains on the sale of ordinary shares held by non-Israeli resident investors for tax purposes will generally be exempt from Israeli capital gains tax subject to the provisions of the Israeli tax legislation. 95 However, dealers in securities in Israel and companies taxed under the Inflationary Adjustment Law are taxed at regular tax rates applicable to business income. INFLATIONARY ADJUSTMENTS. The Income Tax (Inflationary Adjustments) Law, 1985 attempts to overcome some of the problems of a tax system effected by an economy experiencing rapid inflation. This was the case in Israel at the time the law was enacted. Generally, this law provides significant tax deductions and adjustments to depreciation methods, finance income and expenses and tax loss carry forwards to compensate for loss of value resulting from an inflationary economy. Elbit Systems' taxable income is determined under this law. However, due to low inflation during 2000 portions of this law were temporarily suspended. In 2001, the provisions of the law were re-implemented since the inflation during the year exceeded 3%. In 2002 inflation during the year exceeded 6%. In 2003 the inflation rate was a negative 1.9%. INCOME TAX FOR NON-RESIDENTS OF ISRAEL. Non-residents of Israel are subject to a graduated income tax on income from sources in Israel. On distributions of dividends other than bonus shares (stock dividends), the paying company withholds at source income tax at the rate of 25%, unless a lower rate is applicable under a double taxation treaty. Generally, dividends distributed from taxable income accrued during the period of benefit of an Approved Enterprise are taxable at the rate of 15% if the dividend is distributed during the tax benefit period under the Investment Law or within 12 years after the period. (This limitation does not apply if the company qualifies as a foreign investors' company according to the Investment Law.) These rates are the final tax on dividends for individual and corporate non-residents and for individual Israeli residents. Foreign residents who have Israeli derived income for which tax was withheld at the source are generally exempt from the duty to file tax returns in Israel for such income. This includes income from Israeli derived interest, dividends and royalties. ISRAELI TAX ON UNITED STATES SHAREHOLDERS Dividends paid by Elbit Systems to a shareholder resident in the United States are generally subject to withholding tax deducted at source in Israel. Israel and the United States are parties to a tax treaty. Under the treaty, the withholding tax rate on a dividend is normally 25% of the dividend amount, or 15% in connection with an Approved Enterprise. A U.S. corporation would have a reduced withholding rate on dividends if it were to own 10% or more of Elbit Systems' voting shares under specified conditions. The reduced withholding tax rate on the dividend would be 12.5%. The U.S. corporation must own at least 10% of the voting shares during the portion of Elbit Systems' tax year before the payment of the dividend and during the entire prior tax year. The reduced rate is also subject to two other conditions. First, not more than 25% of Elbit Systems' gross income for the prior tax year could consist of interest, other than interest received from banking, financing or similar businesses or from certain subsidiaries. Second, the dividend cannot be derived from income during any period for which Elbit Systems is entitled to the reduced tax rate applicable to an Approved Enterprise. In this case the withholding tax rate would be 15%. Under the terms of the tax treaty, Israel may tax, subject to any exemptions under Israeli law, any capital gain realized by a shareholder resident in the United States on a sale of Elbit Systems' shares if the shareholder owned, directly or indirectly, 10% or more of Elbit Systems' voting shares at any time during the 12-month period before the sale or the above shareholder is an individual and was present in Israel for more than 183 days during the relevant taxable year. However, according to a new amendment in the Israeli Tax Ordinance, effective January 1, 2003, since Elbit Systems ordinary shares are traded on the TASE and on Nasdaq, gains on the sale of ordinary shares held by non-Israeli resident investors for tax purposes will generally be exempt from Israeli capital gains tax, subject to the provisions of the Israeli tax legislation. 96 With some limitations, any Israeli tax withheld or paid for dividends on ordinary shares generally will be eligible for credit against a U.S. shareholder's U.S. federal income tax liability. Such limitations include separate computation rules limiting foreign tax credits allowable for specific classes of foreign source income. The tax credits are limited to the corresponding U.S. federal income taxes otherwise payable for each such class of income. Alternatively, a U.S. shareholder may elect to claim a U.S. tax deduction for such Israeli tax, but only for a year in which the U.S. shareholder elects to do so for all foreign income taxes. This summary of taxation is based on existing treaties, laws, regulations and judicial and administrative interpretations. There can be no assurance that any of these may not be amended or repealed, possibly with retroactive effect, or that a tax authority may take a contrary position. Also, this summary does not address the tax consequences that may be applicable to specific persons based on their individual circumstances. It also does not address any state, local or other foreign tax consequences. A shareholder should consult his or her own tax advisor as to the specific tax consequences of purchasing, holding or transferring shares of Elbit Systems. DOCUMENTS ON DISPLAY Elbit Systems is subject to the informational requirements of the Securities Exchange Act of 1934, as amended. In accordance with these requirements, Elbit Systems files reports and other information with the SEC. These materials, including this Annual Report and its exhibits, may be inspected and copied at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the SEC's regional office at 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Copies of the materials may be obtained from the Public Reference Room of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. The public may obtain information on the operation of the Commission's Public Reference Room by calling the SEC in the United States at 1-800-SEC-0330. 97 ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK. While our functional currency is the U.S. dollar, we also have some non-U.S. dollar or non-U.S. dollar linked currency exposure from time to time. See above - Item 5. Operating Financial Review and Prospects - Management's Discussion and Analysis - Impact of Inflation and Exchange Rates - Foreign Currency Expenses. Except when we view it necessary, we do not invest in derivative financial instruments or other market risk sensitive instruments. Therefore, we do not believe that we are exposed to any material market risk with regard to market risk sensitive instruments. ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES. Not applicable. ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES. Not applicable. ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS. Not applicable. ITEM 15. CONTROLS AND PROCEDURES We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our periodic filings with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These controls and procedures also provide that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Also, management necessarily was required to use its judgment in evaluating the cost to benefit relationship of possible disclosure controls and procedures. Within 90 days prior to the date of this report, we performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. The evaluation was performed with the participation of senior management of major business areas and key corporate functions, and under the supervision of the CEO and CFO. Based on the evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls after the date we completed the evaluation. 98 ITEM 16. ITEM 16.A - AUDIT COMMITTEE FINANCIAL EXPERT Yaacov Lifshitz, a member of our Audit Committee, meets the criteria of an "Audit Committee Financial Expert" under the applicable rules and regulations of the SEC, and his designation as the Audit Committee's Financial Expert has been ratified by the Board. Mr. Lifshitz is "independent", as that term is defined in the Nasdaq listing standards. ITEM 16.B - CODE OF ETHICS We have adopted a code of business conduct and ethics that is applicable to all our directors, officers and employees including our principal executive, financial and accounting officers and persons performing similar functions. The code of ethics was approved by our Board and covers areas of professional and business conduct. It is intended to promote honest and ethical behavior, including fair dealing and the ethical handling of conflicts of interest. The code of ethics includes a "whistleblower" process to encourage reports of violations. Our code of ethics is posted on our website: www.elbitsystems.com . ITEM 16.C - PRINCIPAL ACCOUNTANT FEES AND SERVICES In the annual general shareholders meeting held in August 2003, our shareholders reappointed Kost Forer Gabbay & Kasierer (Kost), a member of Ernst & Young Global (E&Y), to serve as our independent auditors. We paid to Kost and other E&Y affiliates the following fees for professional services in each of the last two fiscal years: Year Ended December 31 2003 2002 ---- ---- (U.S. dollars in thousands) Audit Fees $616 $556 Audit-Related Fees $40 $46 Tax Fees $398 $159 All Other Fees $54 $67 ------- ----- Total $1,108 $828 99 "Audit Fees" are the aggregate fees billed for the audit of our annual financial statements. This category also includes services generally provided by the independent auditor, such as statutory audits required by the Office of the Chief Scientist and other Israeli government entities, consents and assistance with and review of documents filed with the SEC. "Audit Related Fees" are the aggregate fees billed for assurance and related services that are reasonably related to the performance of the audit and are not reported under Audit Fees. These fees include mainly accounting consultations regarding the accounting treatment of matters that occur in the regular course of business, implications of new accounting pronouncements and other accounting issues that occur from time to time. "Tax Fees" are the aggregate fees billed for professional services rendered for tax compliance and tax advice, other than in connection with the audit. Tax compliance involves preparation of original and amended tax returns, tax planning and tax advice. "Other Fees" relate to permissible services provided by the independent auditors that do not fall into the three above-mentioned categories. Our Audit Committee has adopted a pre-approval policy for the engagement of our independent accountant to perform permitted audit and non-audit services. Under this policy, which is designed to assure that such engagements do not impair the independence of our auditors, the Audit Committee pre-approves annually a range of specific audit and non-audit services in the categories of Audit Service, Audit-Related Services, Tax Services and other services that may be performed by our independent accountants, and the maximum pre-approved fees that may be paid as compensation for each pre-approved service in those categories. Any proposed services exceeding the maximum pre-approved fees require specific approval by the Audit Committee. ITEMS 16.D - EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES Not yet applicable to Registrant. ITEMS 16.E - PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS Neither Elbit Systems nor any affiliated purchaser purchased any of Elbit Systems' equity securities during 2003. 100 ITEM 17. FINANCIAL STATEMENTS. Not applicable. ITEM 18. FINANCIAL STATEMENTS. See Financial Statements attached. ITEM 19. EXHIBITS. (a) Index to Financial Statements Page ---- Independent Auditors' Reports F-2 Consolidated Balance Sheets at December 31, 2002 and 2003 F-5 Consolidated Statements of Income F-7 Consolidated Statements of Shareholders' Equity F-8 Consolidated Statements of Cash Flows F-10 Notes to Consolidated Financial Statements F-12 Schedule II - Valuation and Qualifying Accounts S-1 (b) Exhibits 1.1 Elbit Systems' Memorandum of Association * 1.2 Elbit Systems' Restated Articles of Association 4.1 Spin-off Agreement among Elbit Ltd., Elbit Medical Imaging Ltd. and Elbit Systems ** 4.2 Technology Assignment and Cross License Agreement among Elbit Ltd., Elbit Medical Imaging Ltd. and Elbit Systems ** 4.3 Lease Agreement with Elbit Ltd. ** 4.4 Merger Agreement between Elbit Systems and Elop Electro-Optics Industries Ltd. *** 4.5 Shareholders Agreement between Elron Electronic Industries Ltd. and the Federmann Group *** 4.6 Form of Registration Rights Agreement among Elbit Systems, Elron and the Federmann Group *** 4.7 Elbit Systems' Post Merger Stock Option Plan (Summary in English) * 8.1 List of material subsidiaries and jurisdictions of incorporation 10.1 Consent of Kost Forer Gabbay & Kasierer 31.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 101 31.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 32.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. 32.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ------------------------------ * Filed as an exhibit to Elbit Systems' Annual Report on Form 20-F (File No. 0-28998) for the year ended December 31, 2000, which was filed with the Securities and Exchange Commission on April 5, 2001, and incorporated herein by reference. ** Filed as an exhibit to Elbit Systems' Registration Statement on Form 20-F (File No. 0-28998), which was filed with the Securities and Exchange Commission on November 22, 1996, and incorporated herein by reference. *** Filed as an exhibit to Elbit Systems' Report on Form 6-K for February 2000, which was filed by Elbit Systems with the Securities and Exchange Commission on March 6, 2000, and incorporated herein by reference. 102 SIGNATURES Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized. Dated: June 14, 2004

ELBIT SYSTEMS LTD. By: /s/ Joseph Ackerman ------------------------------------ Name: Joseph Ackerman Title: President and Chief Executive Officer 103 ELBIT SYSTEMS LTD. AND SUBSIDIARIES SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS (In thousands of U.S. dollars) COLUMN A COLUMN B COLUMN C COLUMN D COLUMN E Additions Charged to Balance at Charged to Other Balance at DESCRIPTION Beginning Costs and Accounts Deductions End of ----------- of Period Expenses (Describe) (Describe) Period --------- -------- ---------- ---------- ------ YEAR ENDED DECEMBER 31, 2003: Deducted from Assets Accounts: Allowance for Doubtful Accounts...... 3,411 908 458 3,861 Provisions for Additional Work on Systems and Products Delivered, Warranties and Expected Losses....... 57,395 20,361 24,452 53,304 YEAR ENDED DECEMBER 31, 2002: Deducted from Assets Accounts: Allowance for Doubtful Accounts...... 3,200 459 248 3,411 Provisions for Additional Work on Systems and Products Delivered, Warranties and Expected Losses....... 51,132 34,541 28,278 57,395 YEAR ENDED DECEMBER 31, 2001: Deducted from Assets Accounts: Allowance for Doubtful Accounts...... 2,957 270 -- 27 3,200 Provisions for Additional Work on Systems and Products Delivered, Warranties and Expected Losses....... 44,019 31,345 345(1) 24,577 51,132 -------------------- (1) Acquisition of subsidiaries S-1 EXHIBIT INDEX 1.1 Elbit Systems' Memorandum of Association * 1.2 Elbit Systems' Restated Articles of Association 4.1 Spin-off Agreement among Elbit Ltd., Elbit Medical Imaging Ltd. and Elbit Systems ** 4.2 Technology Assignment and Cross License Agreement among Elbit Ltd., Elbit Medical Imaging Ltd. and Elbit Systems ** 4.3 Lease Agreement with Elbit Ltd. ** 4.4 Merger Agreement between Elbit Systems and Elop Electro-Optics Industries Ltd. *** 4.5 Shareholders Agreement between Elron Electronic Industries Ltd. and the Federmann Group *** 4.6 Form of Registration Rights Agreement among Elbit Systems, Elron and the Federmann Group *** 4.7 Elbit Systems' Post Merger Stock Option Plan (Summary in English) * 8.1 List of material subsidiaries and jurisdictions of incorporation 10.1 Consent of Kost Forer Gabbay & Kasierer 31.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 31.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 32.1 Certification of Chief Executive Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. 32.2 Certification of Chief Financial Officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ------------------------------- * Filed as an exhibit to Elbit Systems' Annual Report on Form 20-F (File No. 0-28998) for the year ended December 31, 2000, which was filed with the Securities and Exchange Commission on April 5, 2001, and incorporated herein by reference. ** Filed as an exhibit to Elbit Systems' Registration Statement on Form 20-F (File No. 0-28998), which was filed with the Securities and Exchange Commission on November 22, 1996, and incorporated herein by reference. *** Filed as an exhibit to Elbit Systems' Report on Form 6-K for February 2000, which was filed by Elbit Systems with the Securities and Exchange Commission on March 6, 2000, and incorporated herein by reference. -------------------------------------- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES -------------------------------------- CONSOLIDATED FINANCIAL STATEMENTS as of December 31, 2003 ----------------------- (In U.S. dollars) -------------------------------------- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES -------------------------------------- CONSOLIDATED FINANCIAL STATEMENTS as of December 31, 2003 (In U.S. dollars) C O N T E N T S Page ---- REPORT OF INDEPENDENT AUDITORS 2 - 4 CONSOLIDATED FINANCIAL STATEMENTS Consolidated Balance Sheets 5 - 6 Consolidated Statements of Income 7 Statements of Changes in Shareholders' Equity 8 - 9 Consolidated Statements of Cash Flows 10 - 11 Notes to the Consolidated Financial Statements 12 - 58 # # # # # # # [ERNST & YOUNG LOGO] REPORT OF INDEPENDENT AUDITORS To the Shareholders of Elbit Systems Ltd. We have audited the accompanying consolidated balance sheet of Elbit Systems Ltd. (the "Company") and its subsidiaries as of December 31, 2003, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year ended December 31, 2003. Our audits also included the financial statement schedule listed in the Index at Item 19a. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2003, and the consolidated results of their operations and cash flows for the year ended December 31, 2003, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein. As discussed in Note 2 to the consolidated financial statements, effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible assets". Kost Forer Gabbay & Kasierer A member of Ernst & Young Global Haifa, Israel March 9, 2004 -2- [ERNST & YOUNG LOGO] REPORT OF INDEPENDENT AUDITORS To the Shareholders of Elbit Systems Ltd. We have audited the accompanying consolidated balance sheet of Elbit Systems Ltd. (the "Company") and its subsidiaries as of December 31, 2002, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of Elbit Systems Ltd. As of December 31, 2001 and for the year then ended were audited by other auditors who have ceased operations as a foreign associated firm of the Securities and Exchange Commission Practice Section of the American Institute of Certified Public Accountants and whose report dated March 24, 2002, expressed an unqualified opinion on those statements. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above, present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2002 and the consolidated results of their operations and cash flows fro the year then ended in conformity with accounting principles generally accepted in the United States. As discussed in Note 2 to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002. LUBOSHITZ KASIERER AN AFFILIATE MEMBER OF ERNST & YOUNG INTERNATIONAL Haifa, Israel March 10, 2003 -3- This is a copy of the previously issued Independent Public Account's report of Arthur Andersen. The report has not been reissued by Arthur Andersen. REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS To the Shareholders of ELBIT SYSTEMS LTD. We have audited the accompanying consolidated balance sheets of Elbit Systems Ltd. and its subsidiaries as of December 31, 2001 and 2000 and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Elbit Systems Ltd. and its subsidiaries as of December 31, 2001 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States. Luboshitz Kasierer Arthur Andersen Haifa, Israel March 24, 2002 -4- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES CONSOLIDATED BALANCE SHEETS -- U. S. dollars (In thousands) December 31, ------------------------------- Note 2003 2002 ----------- ------------- ------------- CURRENT ASSETS: Cash and cash equivalents $ 76,156 $ 76,280 Short-term bank deposits 690 1,650 Trade receivables, net (3) 203,281 225,773 Other receivables and prepaid expenses (4) 48,363 42,698 Inventories, net of advances (5) 249,225 220,399 ------------- ------------- Total current assets 577,715 566,800 ------------- ------------- INVESTMENTS AND LONG-TERM RECEIVABLES: Investments in affiliated companies and partnership (6A) 26,478 21,947 Investments in other companies (6B) 11,745 11,104 Long-term trade receivables 393 20,859 Long-term bank deposits and loan (7) 1,954 3,686 Severance pay fund (2N) 76,218 67,024 -------------- -------------- 116,788 124,620 -------------- -------------- PROPERTY, PLANT AND EQUIPMENT, NET (8) 229,221 202,961 -------------- -------------- OTHER ASSETS, NET: (9) Goodwill 32,576 32,162 Know-how and other intangible assets, net 67,436 73,607 -------------- -------------- 100,012 105,769 -------------- -------------- $ 1,023,736 $ 1,000,150 ============== ============== The accompanying notes are an integral part of the consolidated financial statements -5- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES CONSOLIDATED BALANCE SHEETS --- U. S. dollars (In thousands, except per share data) December 31, --------------------------------- Note 2003 2002 ----------- -------------- -------------- CURRENT LIABILITIES: Short-term bank credit and loans (10) $ 8,509 $ 24,302 Current maturities of long-term loans (13) 6,818 6,613 Trade payables 107,545 82,094 Other payables and accrued expenses (11) 156,527 141,304 Customers advances and amounts in excess of costs incurred on contracts in progress (12) 99,618 106,467 -------------- --------------- Total current liabilities 379,017 360,780 -------------- --------------- LONG-TERM LIABILITIES: Long-term loans (13) 62,038 73,173 Advances from customers (12) 7,592 40,411 Deferred income taxes (15E) 24,916 24,735 Accrued severance pay (14,2N) 93,979 84,973 -------------- --------------- 188,525 223,292 -------------- --------------- COMMITMENTS AND CONTINGENT LIABILITIES (16) MINORITY INTERESTS 4,115 4,717 -------------- --------------- SHAREHOLDERS' EQUITY (17) Share capital Ordinary shares of New Israeli Shekels (NIS) 1 par value; Authorized - 80,000,000 shares as of December 31, 2003 and 2002; Issued - 39,746,125 and 39,212,328 shares as of December 31, 2003 and 2002, respectively; Outstanding - 39,337,304 and 38,803,507 shares as of December 31, 2003 and 2002, respectively 11,273 11,154 Additional paid-in capital 259,033 248,387 Accumulated other comprehensive loss (3,992) (2,882) Retained earnings 190,086 159,023 Treasury shares - 408,821 shares as of December 31, 2003 and 2002 (4,321) (4,321) -------------- --------------- 452,079 411,361 -------------- --------------- $ 1,023,736 $ 1,000,150 ============== =============== The accompanying notes are an integral part of the consolidated financial statements -6- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME --- U. S. dollars (In thousands, except per share data) Year ended December 31, Note 2003 2002 2001 ---- ---- ---- ---- Revenues (18) $897,980 $827,456 $764,501 Cost of revenues 673,561 605,313 553,957 -------- -------- -------- Gross profit 224,419 222,143 210,544 -------- -------- -------- Research and development costs, net (19) 54,919 57,010 58,759 Marketing and selling expenses 69,943 65,691 54,876 General and administrative expenses 46,077 41,651 43,216 -------- -------- -------- 170,939 164,352 156,851 -------- -------- -------- Operating income 53,480 57,791 53,693 Financial expenses, net (20) (4,870) (3,035) (2,617) Other income (expenses), net (21) 903 (462) 774 -------- -------- -------- Income before taxes on income 49,513 54,294 51,850 Taxes on income (15) 11,334 9,348 11,003 -------- -------- -------- 38,179 44,946 40,847 Equity in net earnings (losses) of affiliated companies and partnership 7,209 675 (598) Minority interests in losses (earnings) of subsidiaries 557 (508) 547 -------- -------- -------- Net income $ 45,945 $45,113 $40,796 ======== ======== ======== Earnings per share (17G) Basic net earnings per share $ 1.18 $ 1.17 $ 1.07 ======== ======== ======== Diluted net earnings per share $ 1.14 $ 1.13 $ 1.04 The accompanying notes are an integral part of the consolidated financial statements -7- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY -- U. S. dollars (In thousands, except per share data) Accumulated Number of Additional other outstanding Share paid-in comprehensive shares capital capital loss ------------- ------------ ------------ ---------------- Balance as of January 1, 2001 37,811,398 $ 10,916 $ 235,462 $ - Exercise of options 585,860 138 3,162 - Tax benefit in respect of options exercised - - 1,363 - Adjustment to capital reserve - - (3,874) - Amortization of stock based compensation - - 8,512 - Purchase of treasury shares (66,986) - - - Dividends paid - - - - Net income - - - - ---------- ---------- ---------- ---------- Balance as of December 31, 2001 38,330,272 11,054 244,625 - Exercise of options 473,235 100 4,040 - Tax benefit in respect of options exercised - - 648 - Amortization of stock based compensation - - (926) - Dividends paid - - - - Comprehensive income (loss): Minimum pension liability - - - (2,882) Net income - - - - ---------- ---------- ---------- ---------- Total comprehensive income Balance as of December 31, 2002 38,803,507 $ 11,154 $ 248,387 $ (2,882) ========== ========== ========== ========== Total Total other Retained Treasury shareholders' comprehensive earnings shares equity income ------------ ------------ ------------- --------------- Balance as of January 1, 2001 $ 97,963

$ (3,613) $ 340,728 Exercise of options - - 3,300 Tax benefit in respect of options exercised - - 1,363 Adjustment to capital reserve - - (3,874) Amortization of stock based compensation - - 8,512 Purchase of treasury shares - (708) (708) Dividends paid (12,132) - (12,132) Net income 40,796 - 40,796 $ 40,796 --------- --------- --------- --------- Total comprehensive income $ 40,796 ========= Balance as of December 31, 2001 126,627 (4,321) 377,985 Exercise of options - - 4,140 Tax benefit in respect of options exercised - - 648 Amortization of stock based compensation - - (926) Dividends paid (12,717) - (12,717) Comprehensive income (loss): Minimum pension liability - - (2,882) $ (2,882) Net income 45,113 - 45,113 45,113 --------- --------- --------- --------- Total comprehensive income $ 42,231 ========= Balance as of December 31, 2002 $ 159,023 $ (4,321) $ 411,361 ========= ========= ========= The accompanying notes are an integral part of the consolidated financial statements -8- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (CONT.) -- U. S. dollars (In thousands, except per share data) Accumulated Number of Additional other outstanding Share paid-in comprehensive shares capital capital loss ------------- ------------ ------------ ---------------- Balance as of December 31, 2002 38,803,507 $ 11,154 $ 248,387 $ (2,882) Exercise of options 533,797 119 5,147 - Tax benefit in respect of options exercised - - 758 - Amortization of stock based compensation - - 4,741 - Dividends paid - - - - Comprehensive income (loss): Unrealized gains on derivative instruments - - - (578) Foreign currency translation differences - - - 340 Minimum pension liability - - - (872) Net income - - - - ------------ ------------ ------------ ------------ Total comprehensive income Balance as of December 31, 2003 39,337,304 $ 11,273 $ 259,033 $ (3,992) ============ ============ ============ ============ Accumulated other comprehensive loss ----------------------------------- Accumulated gains on derivative instruments $ (578) Accumulated foreign currency translation differences 340 Accumulated minimum pension liability (3,754) ------------ Accumulated other comprehensive loss as of December 31, 2003 $ (3,992) ============ Total Total other Retained Treasury shareholders' comprehensive earnings shares equity income ------------ ------------- ------------- ---------------- Balance as of December 31, 2002 $ 159,023 $ (4,321) $ 411,361 Exercise of options - - 5,266 Tax benefit in respect of options exercised - - 758 Amortization of stock based compensation - - 4,741 Dividends paid (14,882) - (14,882) Comprehensive income (loss): Unrealized gains on derivative instruments - - (578) $ (578) Foreign currency translation differences - - 340 340 Minimum pension liability - - (872) (872) Net income 45,945 - 45,945 45,945 --------- --------- --------- --------- Total comprehensive income $ 44,835 ========= Balance as of December 31, 2003 $ 190,086 $ (4,321) $ 452,079 ========= ========= ========= The accompanying notes are an integral part of the consolidated statements. -9- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS --- U. S. dollars (In thousands) Year ended December 31, ---------------------- 2003 2002 2001 ---- ---- ---- CASH FLOWS FROM OPERATING ACTIVITIES Net income $ 45,945 $ 45,113 $ 40,796 Adjustments required to reconcile net income to net cash provided by operating activities: Depreciation and amortization 37,890 32,937 32,865 Amortization of deferred stock based compensation 4,741 (926) 8,512 Deferred income taxes, net 35 (5,620) (2,694) Accrued severance pay, net (1,240) 6,260 (633) Gain (loss) on sale of property, plant and equipment (915) 743 (327) Tax benefit in respect of options exercised 758 648 1,363 Minority interests in earnings (losses) of subsidiaries (557) 508 (547) Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*) (4,995) (675) 598 Changes in operating assets and liabilities: Decrease (increase) in short and long-term receivables and prepaid expenses 45,297 58,554 (9,963) Increase in inventories (38,651) (55,106) (72,165) Increase (decrease) in trade payable, other payables and accrued expenses 32,147 (19,321) 37,004 Increase (decrease) in advances received from customers (27,855) 42,999 6,489 Settlement of royalties with the Office of the Chief Scientist (1,581) 9,197 - Other adjustments 337 683 (117) --------- --------- --------- Net cash provided by operating activities 91,356 115,994 41,181 --------- --------- --------- CASH FLOWS FROM INVESTING ACTIVITIES Purchase of property, plant and equipment (61,287) (46,003) (45,244) Investment grants received for property, plant and equipment - 119 1,334 Acquisition of subsidiaries and businesses (Schedule A) (2,458) (5,280) (3,344) Investments in affiliated companies and subsidiaries (1,049) (1,681) (801) Proceeds from sale of property, plant and equipment 5,815 956 3,010 Grant of long-term loan - (714) - Repayment of long-term loan 2,400 - - Repayment of short-term loan - 1,371 - Investment in long-term bank deposits (1,750) (1,228) (1,872) Proceeds from sale of long-term bank deposits 3,568 1,689 2,322 Short-term bank deposits, net 960 (204) (57) --------- --------- --------- Net cash used in investing activities (53,801) (50,975) (44,652) --------- --------- --------- CASH FLOWS FROM FINANCING ACTIVITIES Proceeds from exercise of options 5,266 4,140 3,300 Repayment of long-term credit for purchase of a building - - (3,000) Purchase of treasury shares - - (708) Repayment of long-term bank loans (27,066) (3,249) (13,049) Proceeds from long-term bank loans 10,000 2,233 25,444 Dividends paid (14,882) (12,717) (12,132) Change in short-term bank credit and loans, net (10,997) (19,729) (6,517) --------- --------- --------- Net cash used in financing activities (37,679) (29,322) (6,662) --------- --------- --------- NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS (124) 35,697 (10,133) CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR 76,280 40,583 50,716 --------- --------- --------- CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR $ 76,156 $ 76,280 $ 40,583 ========= ========= ========= (*) Dividend received $ 2,214 $ - $ - ========= ========= ========= The accompanying notes are an integral part of the consolidated financial statements. -10- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.) -- U. S. dollars (In thousands) Year ended December 31, ----------------------- 2003 2002 2001 ---- ---- ---- SUPPLEMENTAL CASH FLOWS INFORMATION: Cash paid during the year for: Income taxes $ 14,666 $ 21,730 $ 9,469 ======== ======== ======== Interest $ 4,034 $ 2,947 $ 6,649 ======== ======== ======== SCHEDULE A: Subsidiaries and businesses acquired (*) Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition was as follows: Working capital deficiency (excluding cash and cash equivalents) $ 657 $ - $ 888 Property, plant and equipment (249) (275) (1,886) Goodwill, know-how and other intangible assets (1,334) (5,078) (3,800) Deferred income taxes (1,765) - - Long-term liabilities 198 - 1,454 Minority interest 35 - - -------- -------- -------- (2,458) (5,353) (3,344) Less short-term debt incurred on acquisition - 73 - -------- -------- -------- $ (2,458) $ (5,280) $ (3,344) ======== ======== ======== (*) AEL in 2001 (see Note 1C). Defense systems division of Elron Telesoft in 2002 (see Note 1D). In 2003 OIP (see Note 1E) and AD&D (see Note 1F). The accompanying notes are an integral part of the consolidated financial statements. -11- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS -- U. S. dollars (In thousands) Note 1 - GENERAL A. Elbit Systems Ltd. (the "Company") is an Israeli corporation, 30% owned by the Federmann Group and 20% owned by Elron Electronic Industries Ltd. ("Elron"). The Company's shares are traded on the Tel Aviv Stock Exchange and on the Nasdaq National Market in the United States. The Company and its subsidiaries (the "Group") are engaged mainly in the field of defense electronics. The Company's principal wholly owned subsidiaries are EFW Inc. ("EFW") and Elop Electro-Optics Industries Ltd. ("El-Op"). B. A majority of the Group's revenues were derived in recent years from direct or indirect sales to governments or to government agencies. As a result, a substantial portion of the Group's sales is subject to the special risks associated with sales to governments or to government agencies. These risks include, among others, the dependency on the resources allocated by governments to defense programs, changes in governmental priorities and changes in governmental approvals regarding export licenses required for the Group products and for its suppliers. As for a major customer refer to Note 18C. C. In 2001, the Company acquired a 62.5% interest in Aeroeletronica - Industria de Componentes Avionicos S.A. ("AEL"), a Brazilian company located in Porto Alegre, for approximately $3,450 in cash. In July 2002, the Company acquired the remaining 37.5% interest for an additional $900 in cash. The consideration paid included approximately $1,200 held in escrow, pending final resolution of certain liabilities and contingencies of AEL to be resolved over a period of five years following the acquisition. The excess of cost over the fair value of net liabilities acquired of approximately $6,700 was allocated to land ($1,200) and identifiable intangible assets ($5,500), to be amortized over a period of 8 years. AEL serves as a center for the production and logistics support of defense electronics for programs in Brazil. The results of AEL's operations have been included in the consolidated financial statements from the date of acquisition. Pro forma information in accordance with Statement of Financial Accounting Standards No. 141 "Business Combinations" ("SFAS No. 141") has not been provided, since the revenues and net income of AEL were not material in relation to total consolidated revenues and net income for the year 2001. -12- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 1 - GENERAL (Cont.) D. In January 2002, the Company acquired from Elron Telesoft Inc. and its subsidiaries ("Elron Telesoft") the assets and the business of the Defense Systems Division of Elron Telesoft ("the Government Division") in consideration for $5,700 in cash. The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $5,100 was allocated to technology and other intangible assets to be amortized over a weighted average period of 3 years. The Government Division is engaged mainly in the development of communication systems, information technology and image intelligence processing for defense and military applications. The results of the Government Division have been included in the consolidated financial statements from the first quarter of 2002. Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of the Government Division were not material in relation to total consolidated revenues and net income for the years 2001 and 2002. E. In June 2003, the Company (through El-Op) acquired all of the outstanding Ordinary shares of Optronics Instruments & Products N.V. (O.I.P.), a company registered in Belgium, in consideration for $1,846 in cash. The acquisition was accounted for by the purchase method of accounting. O.I.P. develops, manufactures and supports electro-optical products, mainly for the defense and space markets. The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition as estimated by the Company: Current assets $ 6,896 Property and equipment 168 Deferred tax assets 1,700 -------- Total assets acquired 8,764 Current liabilities (6,918) -------- Net assets acquired $ 1,846 ======== The results of O.I.P.'s operations have been included in the consolidated financial statements from the date of acquisition. -13- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 1 - GENERAL (Cont.) Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of O.I.P. were not material in relation to total consolidated revenues and net income for the years 2001, 2002 and 2003. F. In July 2003, the Company acquired approximately 54% of the outstanding shares of Aero Design Development Ltd. ("AD&D") an Israeli company in consideration for $1,406 in cash. The acquisition was accounted for by the purchase method of accounting. AD&D develops, manufactures and builds airborne models and other engineered products. The purchase price over the fair value of net tangible assets acquired in the amount of approximately $1,334 was allocated to know-how ($1,000) to be amortized by the straight-line method over a period of 10 years and to goodwill ($334). The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition as estimated by the Company: Current assets $ 604 Property and equipment 81 Know-how and goodwill 1,334 Deferred tax assets 65 --------- Total assets acquired 2,084 Current liabilities (445) Long-term liabilities (198) Minority interest (35) --------- Net assets acquired $ 1,406 ========= The results of AD&D.'s operations have been included in the consolidated financial statements from the date of acquisition. Pro forma information in accordance with SFAS No. 141 has not been provided, since the revenues and net income of AD&D were not material in relation to total consolidated revenues and net income for the years 2001, 2002 and 2003. -14- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"). As applicable to the consolidated financial statements of the Group, such principles are substantially identical to accounting principles generally accepted in Israel, except as described in Note 23. A. USE OF ESTIMATES The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported and disclosure of contingent assets and liabilities in the financial statements and accompanying notes. Actual results could differ from those estimates. B. FINANCIAL STATEMENTS IN U.S. DOLLARS The Company's revenues are generated mainly in U.S. dollars. In addition, most of the Company's costs are incurred in U.S. dollars. The Company's management believes that the U.S. dollar is the primary currency of the economic environment in which the Company operates. Thus, the functional and reporting currency of the Company is the U.S. dollar. Transactions and balances originally denominated in U.S. dollars are presented at their original amounts. Transaction and balances in other currencies have been remeasured into U.S. dollars in accordance with principles set forth in SFAS No. 52 "Foreign Currency Translation". All exchange gain and losses from the remeasurement mentioned above are reflected in the statement of income in financial income or expenses. For those foreign subsidiaries whose functional currency has been determined to be other than the U.S. dollar, assets and liabilities are translated at year-end exchange rates and statement of income items are translated at average exchange rates prevailing during the year. Such translation adjustments are recorded as a separate component of accumulated other comprehensive income in shareholders' equity. -15- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 -

SIGNIFICANT ACCOUNTING POLICIES (CONT.) C. PRINCIPLES OF CONSOLIDATION The consolidated financial statements include the accounts of the Company and its wholly and majority-owned subsidiaries. The consolidated subsidiaries include El-Op, EFW and other Israeli and non-Israeli subsidiaries. Intercompany transactions and balances including profit from intercompany sales not yet realized outside the Group have been eliminated upon consolidation. D. CASH EQUIVALENTS Cash equivalents, are short-term highly liquid investments that are readily convertible to cash with maturities of three months or less at the date of acquisition. E. SHORT-TERM BANK DEPOSITS Short-term bank deposits are deposits with maturities of more than three months but less than one year. The short-term bank deposits are presented at their cost. F. INVENTORIES Inventories are stated at the lower of cost or net realizable value. Inventory write-offs are provided for slow-moving items or technological obsolescence for which recoverability is not probable. Cost is determined as follows: - Raw materials using the average cost method. - Costs incurred on long-term contracts in progress represent recoverable costs incurred for production, allocable operating overhead and, where appropriate, research and development costs (refer to Note 2Q). Advances from customers are allocated to the applicable contract inventories and are reflected as an offset against the related inventory balances. -16- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) G. INVESTMENT IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES Investments in non-marketable shares of companies in which the Group holds less than 20% and the Group does not have the ability to exercise significant influence over operating and financial policies of the companies are recorded at the lower of cost or estimated fair value. Investments in companies and partnership over which the Group can exercise significant influence (generally, entities in which the Group holds between 20% and 50% of voting rights) are presented using the equity method of accounting. Profits on intercompany sales, not realized outside the Group, were eliminated. The Group discontinues applying the equity method when its investment (including advances and loans) is reduced to zero and it has not guaranteed obligations of the affiliate or otherwise committed to provide further financial support to the affiliate. Certain investments are accounted for under the hypothetical liquidation method. For these investments, the Group applies Emerging Issues Task Force ("EITF 99-10"), "Percentage Used to Determine the Amount of Equity Method Losses", according to which the Group recognizes equity method losses based on the ownership level of the particular investee security or loan held by the Group to which the equity method losses are being applied. The Group's investments in affiliates are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an investment may not be recoverable. As of December 31, 2003, based on management's most recent analyses, no impairment losses have been identified. H. LONG-TERM TRADE RECEIVABLES Long-term trade receivables from extended payment agreements are recorded at their estimated present values (determined based on the original rates of interest). I. LONG-TERM BANK DEPOSITS Bank deposits with maturities of more than one year are presented at cost including accumulated interest. -17- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) J. PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment are stated at cost, net of accumulated depreciation and investment grants. For equipment produced for the Group's own use, cost includes materials, labor and overhead, but not in excess of the fair value of the equipment. Depreciation is calculated by the straight-line method over the estimated useful life of the assets at the following annual rates: % ----- Buildings 2-4 (mainly 4%) Instruments, machinery and equipment 10-33 Office furniture and other 6-33 Motor vehicles 15-20 (mainly 15%) Land rights and leasehold improvements - over the term of the lease. K. IMPAIRMENT OF LONG-LIVED ASSETS The Group's long-lived assets and certain identifiable intangible assets are reviewed for impairment in accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If an asset is determined to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. As of December 31, 2003, no impairment losses have been identified. L. OTHER ASSETS Intangible assets subject to amortization arose from acquisitions prior to July 1, 2001, are being amortized on a straight-line basis over their useful life in accordance with APB Opinion No. 17, "Intangible Assets" ("APB No. 17").

-18- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) L. OTHER ASSETS (CONT.) Intangible assets acquired in a business combination for which date is on or after July 1, 2001, are being amortized over their useful life using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used up, in accordance with Statements of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets", ("SFAS No. 142"). M. GOODWILL Goodwill represents excess of the cost of acquired entities over the net fair values of the assets acquired and liabilities assumed. Goodwill that arose from acquisitions prior to July 1, 2001, was amortized until December 31, 2001, on a straight-line basis over 10 - 20 years. Under SFAS No. 142, such goodwill shall no longer be amortized effective as of January 1, 2002. Goodwill acquired in a business combination on or after July 1, 2001 is not amortized. SFAS No. 142 requires goodwill to be tested for impairment on adoption and at least annually thereafter or between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Goodwill attributable to each of the reporting units is tested for impairment by comparing the fair value of each reporting unit with its carrying value. If the carrying value exceeds the fair value, impairment is measured by comparing the implied fair value of goodwill to its carrying value. Fair value of a reporting unit is determined using discounted cash flows. Significant estimates used in the methodology include estimates of future cash flows, future short-term and long-term growth rates and weighted average cost of capital for each of the reporting units. As of December 31, 2003, no impairment losses have been identified. The adoption of SFAS 142 did not affect the financial position and results of operations of the Group as of January 1, 2002. -19- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) N. SEVERANCE PAY Under Israeli law and employment agreements, the Group's companies in Israel are required to make severance payments and, in certain situations, pay pensions to terminated employees. The calculation is based on the employee's latest salary and the period of his employment. The companies' obligation for severance pay and pension is provided by monthly deposits with insurance companies, pension funds and by an accrual. The value of severance pay funds is presented in the balance sheet and includes profits accumulated to balance sheet date. The amounts deposited may be withdrawn only after fulfillment of the obligations pursuant to Israeli severance pay law or labor agreements. The value of the deposited funds are based on the cash surrendered value of these funds and include immaterial profits. Severance pay expenses for the years ended December 31, 2003, 2002 and 2001, amounted to approximately $11,491, $10,138 and $8,097, respectively. O. REVENUE RECOGNITION The Group generates revenues from long-term contracts involving the design, development, manufacture and integration of defense systems and products and providing support and services for such systems and products. Revenues from long-term contracts are recognized based on Statement of Position 81-1 "Accounting for Performance of Construction-Type and Certain Production - Type Contracts" ("SOP 81-1") on the percentage of completion method. Sales and anticipated profit under long-term fixed-price production type contracts are recorded on a percentage of completion basis, generally using units of delivery as the measurement basis for effort accomplished. Estimated contract profit is included in earnings in proportion to recorded sales. Sales under certain long-term fixed-price contracts which, among other things require a significant amount of development effort in relation to total contract value, are recorded using the cost-to-cost method of accounting where sales and profit are recorded based on the ratio of costs incurred to estimated total costs at completion but not before the Group achieves certain milestones. As for research and development costs accounted for as contract costs refer to Note 2Q. -20- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) O. REVENUE RECOGNITION (CONT.) Sales under long-term fixed-price development and production type contracts are recorded on a percentage of completion basis using cost-to-cost method and units of delivery method, as applicable. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original forecasts. Such changes in estimated gross profit are recorded in results of operations when they are reasonably determinable by management, on a cumulative catch-up basis. Amounts representing contract change orders, claims or other items are included in sales only when they can be reliably estimated and realization is probable. Penalties and awards applicable to performance on contracts are considered in estimating sales and profit rates, and are recorded when there is sufficient information to assess anticipated contract performance. The Group believes that the use of the percentage of completion method is appropriate as the Group has the ability to make reasonably dependable estimates of the extent of progress towards completion, contract revenues and contract costs. In addition, contracts executed include provisions that clearly specify the enforceable rights regarding services to be provided and received by the parties to the contracts, the consideration to be exchanged and the manner and terms of settlement. In all cases the Group expects to perform its contractual obligations and its customers are expected to satisfy their obligations under the contract. Anticipated losses on contracts are charged to earnings when identified. Sales under cost-reimbursement-type contracts are recorded as costs are incurred. Applicable estimated profits are included in earnings in the proportion that incurred costs bear to total estimated costs. -21- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) P. WARRANTY The Group estimates the costs that may be incurred under its basic warranty and records a liability in the amount of such costs at the time revenue is recognized. The specific terms and conditions of those warranties vary depending upon the product sold and the country in which the Group does business. Factors that affect the Group's warranty liability include the number of delivered units, engineering estimates and anticipated rates of warranty claims. The Group periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. Changes in the Group's provision for warranty during the year are as follows: Balance, at January 1, 2003 $ 8,541 Warranties issued during the year 4,491 Warranties forfeited or exercised during the year (3,340) ------- Balance, at December 31, 2003 $ 9,692 ======= Q. RESEARCH AND DEVELOPMENT COSTS Research and development costs, net of participations, are charged to operations as incurred. Group sponsored research and development costs primarily include independent research and development and bid and proposal efforts. Under certain arrangements in which a customer shares in product development costs, the Group's portion of such unreimbursed costs is expensed as incurred. Customer-sponsored research and development costs incurred pursuant to contracts are accounted for as contract costs. Certain Group companies in Israel receive grants (mainly royalty-bearing) from the Government of Israel and from other sources for the purpose of funding approved research and development projects. These grants are recognized at the time the applicable company is entitled to such grants on the basis of the costs incurred and are presented as a deduction from research and development costs. -22- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) R. INCOME TAXES The Group accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes". This Statement prescribes the use of the liability method whereby deferred tax assets and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Group provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value. S. CONCENTRATION OF CREDIT RISKS Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents and trade receivables. The majority of the Group's cash and cash equivalents and deposits are invested in dollar instruments with major banks in Israel and in the U.S. Management believes that the financial institutions that hold the Group investments are financially sound and accordingly, minimal credit risk exists with respect to these investments. The Group's trade receivables are derived primarily from sales to large and solid customers and governments located mainly in Israel, the United States and Europe. The Group performs ongoing credit evaluations of its customers and to date, has not experienced any unexpected material losses except for a one time loss in 2002 of approximately $4,600 due to the insolvency of one of the Group's customers. An allowance for doubtful accounts is determined with respect to those amounts that the Group has determined to be doubtful of collection. -23- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) T. DERIVATIVE FINANCIAL INSTRUMENTS Financial Accounting Standards Board Statement No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"), requires companies to recognize all of its derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e. gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge or a hedge of a net investment in a foreign operations. For derivative instruments that are designated and qualify as a fair value hedge (i.e., hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk), the gain and loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in the same line item associated with the hedged item in current earnings during the period of the change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge (i.e. hedging the exposure to variability in expected future cash flows that is attributable to a particular risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in other income/expense in current earnings during the period of change. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in other income/expense in current earnings during the period of change. -24- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) T. DERIVATIVE FINANCIAL INSTRUMENTS (CONT.) As part of its fair value hedging strategy the Group enters into forward exchange contracts to hedge certain firm commitments denominated in foreign currencies. The purpose of the Group's foreign currency hedging activities is to protect the Group from risk that the eventual dollar cash flows from the sale of products to international customers will be adversely affected by changes in the exchange rates. In addition, in order to ensure the dollar value of certain assets and liabilities, the Group has enters into forward exchange contracts. As part of its cash flows hedging strategy the Group enters into forward exchange contracts to hedge forecasted salary expenses denominated in currency other than the U.S. dollar. As of December 31, 2003, the Group had forward contracts with notional value of approximately $27,500 to purchase and sell foreign currencies. The Group also had options to hedge future cash flow in the amount of $24,000. The forward contracts and the options mature in 2004. The fair value of the foreign exchange contracts as of December 31, 2003 amounted to $1,113. The fair value of the options as of December 31, 2003 is minimal. U. STOCK-BASED COMPENSATION The Company has elected to follow Accounting Principles Board Opinion No. 25 ("APB No. 25") "Accounting for Stock Issued to Employees" and FASB Interpretation No. 44 ("FIN No. 44") "Accounting for Certain Transactions Involving Stock Compensation" in accounting for its employee stock option plans. Under APB No. 25, compensation expense is recognized based on the intrinsic value method where by compensation expense is equal to the excess if any of the quoted market price of the stock at the grant date of the award or other measurement date, over the amount an employee must pay to acquire the stock. The Company recognizes the expense over the vesting period of the award. In respect of phantom share options, the Company applies variable stock compensation accounting (See Note 17C). -25- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) U. STOCK-BASED COMPENSATION (CONT.) The Company adopted the disclosure provisions of Financial Accounting Standards Board Statement No. 148, "Accounting for Stock-Based Compensation - transition and disclosure" ("SFAS No. 148"), which amended certain provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for an entity that voluntarily changes the fair value based method of accounting for stock-based employee compensation, effective as of the beginning of the fiscal year. The Company continues to apply the provisions of APB No. 25, in accounting for stock-based compensation. Pro forma information regarding the Company's net income and net earnings per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method prescribed by SFAS No. 123. The fair value for options granted in 2003, 2002 and 2001 is amortized over their vesting period and estimated at the date of grant using a Black-Scholes options pricing model with the following weighted average assumptions: 2003 2002 2001 ---- ---- ---- Divided yield

2.19% 1.99% 2.03% Expected volatility 19.03% 21.90% 33.80% Risk-free interest 1.20% 1.34% 2.00% Expected life of up to 6 years 6 years 6 years -26- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) U. STOCK-BASED COMPENSATION (CONT.) Pro forma information under SFAS No.123 is as follows: Year ended December 31, 2003 2002 2001 ------------- ------------ ------------ Net income as reported $ 45,945 $ 45,113 $ 40,796 Add - Stock based compensation expense (income), net of related tax effects as reported (intrinsic method) 3,793 (741) 6,810 Deduct - Stock based compensation expense under fair value based method of SFAS 123 net of related tax effects (2,956) (2,956) (2,932) -------- -------- ---------- Pro forma net income $ 46,782 $ 41,416 $ 44,674 ======== ======== ========== Net earnings per share: Basic net earnings per share as reported $ 1.18 $ 1.17 $ 1.07 ======== ======== ========== Diluted net earnings per share as reported $ 1.14 $ 1.13 $ 1.04 ======== ======== ========== Pro forma basic net earnings per share $ 1.20 $ 1.08 $ 1.18 ======== ======== ========== Pro forma diluted net earnings per share $ 1.16 $ 1.04 $ 1.14 ======== ======== ========== V. FAIR VALUE FINANCIAL INSTRUMENTS The carrying amount reported in the balance sheet for cash and cash equivalents, short-term bank deposits, trade receivables, short-term bank credit and loans and trade payables approximate their fair values due to the short-term maturities of such instruments. Long-term loans are estimated by discounting the future cash flows using current interest rates for loans of similar terms and maturities. The carrying amount of the long-term loans approximates their fair value. The fair value of foreign currency contracts (used for hedging purposes) is estimated by obtaining current quotes from investment bankers. -27- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) V. FAIR VALUE FINANCIAL INSTRUMENTS (CONT.) It was not practicable to estimate the fair value of the Group's investments in shares of non-public companies that are accounted for under the cost method because of the lack of a quoted market price and the inability to obtain valuation of each company without incurring excessive costs. The carrying amounts of these companies were $11,104 and $11,745 as of December 31, 2002 and 2003, respectively, and represent the original cost of acquisition. W. BASIC AND DILUTED NET EARNINGS PER SHARE Basic net earnings per share is computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year in accordance with SFAS No. 128 "Earnings Per Share". Outstanding stock options are excluded from the calculation of the diluted net earnings per Ordinary share when such securities are anti-dilutive. In all the years presented no stock options were excluded. X. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34" ("FIN No. 45"). FIN No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. FIN No. 45 does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. It also incorporates, without change, the guidance in FASB Interpretation No.34, "Disclosure of Indirect Guarantees of Indebtedness of Others", which is being superseded. The disclosure provisions of FIN No. 45 are effective for financial statements of interim or annual periods that end after December 15, 2002, and the -28- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) X. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS (CONT.) provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. The adoption of FIN No. 45 did not have a material impact on the Group's results of operations or financial position. In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF Issue No. 00-21 applied to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Additionally, companies will be permitted to apply the consensus guidance in this issue to all existing arrangements as the cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, "Accounting Changes". The adoption of EITF Issue No. 00-21 did not have a material impact upon the Company's consolidated financial position, cash flows or results of operations. In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition." ("SAB No. 104") which revises or rescinds certain sections of SAB No. 101, "Revenue Recognition", in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB NO. 104 did not have a material effect on the Company's consolidated financial position, results of operations or cash flows. In 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51 ("FIN 46"). In December 2003, the FASB revised FIN 46 to make certain technical corrections and address certain implementation issues that had arisen. FIN 46 provides a new framework for identifying Variable Interest Entities ("VIE's") and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a VIE in its consolidated financial statements. -29- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 2 - SIGNIFICANT ACCOUNTING POLICIES (CONT.) X. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS (CONT.) In general, a VIE is an entity that either (1) has an insufficient amount of equity to carry out its principal activities, without additional subordinated financial support, (2) has a group of equity owners that are unable to make significant decisions about the entity's activities, or (3) has a group of equity owners that do not have the obligation to absorb the entity's losses or the right to receive returns generated by its operations. FIN 46 requires the consolidation of a VIE by the primary beneficiary. The primary beneficiary is the entity that absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. The Group is currently evaluating the effects of this interpretation in respect of its investments. It is possible that some of its unconsolidated investees may be considered as VIEs in accordance with the interpretation. Accordingly, if it is determined that the Group is the primary beneficiary of a VIE, the Group will be required to consolidate the financial statements of such VIE with its own financial statements commencing in the first quarter of 2004. Y. RECLASSIFICATIONS Certain financial statement data for prior years has been reclassified to conform with current year financial statement presentation. -30- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 3 - TRADE RECEIVABLES, NET Trade receivables December 31, -------------------- 2003 2002 ---- ---- Open accounts (*) $170,287 $185,997 Unbilled receivables 36,855 43,187 Less - allowance for doubtful accounts (3,861) (3,411) -------- -------- $203,281 $225,773 ======== ======== (*) Includes affiliated companies $ 6,668 $ 9,647 ======== ======== Note 4 - OTHER RECEIVABLES AND PREPAID EXPENSES December 31, -------------------- 2003 2002 ---- ---- Prepaid expenses $ 14,310 $ 12,244 Government departments 5,826 5,915 Employees 513 1,029 Deferred income taxes 21,908 19,997 Others 5,806 3,513 -------- -------- $ 48,363 $ 42,698 ======== ======== Note 5 - INVENTORIES, NET OF ADVANCES December 31, ---------------------------- 2003 2002 ---- ---- Cost incurred on long-term contracts in progress $253,663 $ 210,418 Raw materials 78,504 75,579 Advances to suppliers and subcontractors 20,137 25,047 -------- ---------- 352,304 311,044 Less - Cost incurred on contracts in progress deducted from customer advances 14,581 10,658 -------- ---------- 337,723 300,386 Less - Advances received from customers 77,482 67,624 Provision for losses 11,016 12,363 -------- ---------- $249,225 $ 220,399 ======== ========= The Company has transferred legal title of inventories to certain customers as collateral for advances received. -31- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES A. Investments in companies accounted for under the equity method: December 31, ------------------------- 2003 2002 ---- ---- SCD (1) $ 17,347 $ 15,713 VSI (2) 6,149 3,893 Opgal (3) 2,390 2,028 Others (4) 592 313 -------- -------- $ 26,478 $ 21,947 ======== ======== (1) Semi Conductor Devices ("SCD"), an Israeli partnership, held 50% by the Company and

50% by Rafael Armaments Development Authority Ltd. ("Rafael"). SCD is engaged in the development and production of various thermal detectors and laser diodes. SCD is jointly controlled and therefore is not consolidated in the Company's financial statements. (2) Vision Systems International LLC ("VSI") based in San Jose, is a California limited liability company that is held 50% by EFW. VSI is jointly controlled and therefore is not consolidated in the Company's financial statements. VSI operates in the area of helmet mounted display systems for fixed wing military and paramilitary aircraft. VSI is jointly controlled and therefore is not consolidated in the Company's financial statements. (3) Opgal Optronics Industries Ltd. ("Opgal") is an Israeli company owned 50.1% by the Company and 49.9% by a subsidiary of Rafael. Opgal focuses mainly on commercial applications of thermal imaging and electro-optic technologies. The Company jointly controls Opgal with Rafael, and therefore Opgal is not consolidated in the Company's financial statements. -32- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES (CONT.) A. Investments in companies accounted for under the equity method (cont.) (4) Mediguide Inc. ("Mediguide") and its Israeli subsidiary, Mediguide Ltd., were established in 2000 as a spin-off from the Company, which holds the majority of Mediguide's Ordinary shares. In 2001-2003, Mediguide issued Preferred shares to other investors in consideration for approximately $16,000. The Preferred shares entitle the other investors to preference rights in any liquidation event. Therefore, the Company did not record any gain as a result of the above transaction. In addition the Preferred shares entitle their holders to certain participating rights. Accordingly, based on the guidance in EITF 96-16, the Company does not consolidate Mediguide. The carrying value of the investment in Mediguide is zero. RedC Optical Networks Inc. ("RedC") is engaged in the multi-focal optic communications sector and is held 36.5% by El-Op. RedC designs, develops and manufacture optical amplifiers for dense wave-length multiplexing (DWDM) optical networks for telecommunication renders. Based on analysis performed, the Company recorded a provision for loss on its investment in RedC of $2,500 during the year ended December 31, 2002. This provision has been presented under "Equity in net earnings of affiliated companies and partnership". (5) See Note 16(E) for guarantees. -33- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 6 - INVESTMENTS IN AFFILIATED COMPANIES, PARTNERSHIP AND OTHER COMPANIES (CONT.) B. Investments in companies accounted for under the cost method December 31 ------------------------- 2003 2002 ---- ---- Sultam (1) $ 3,500 $ 3,500 ISI (2) 7,230 7,230 Aero Astro (3) 1,000 - Others 15 374 -------- -------- $ 11,745 $ 11,104 ======== ======== (1) Sultam Systems Ltd. ("Sultam"), held 10%, is an Israeli company engaged in the development and manufacturing of military systems in the artillery sector. (2) ImageSat International N.V. ("ISI"), held 14% (10% on a fully diluted basis), is engaged in the operation of satellite photography formations and commercial delivery of satellite photography for civil purposes. (3) AeroAstro Inc. - In October 2003, the Company purchased Common stock of AeroAstro Inc., ("AAI") a Delaware corporation, representing 8.33% of the total outstanding Common stock of AAI on a fully diluted basis, in consideration for $1,000. AAI is engaged in innovative micro and nanospacecraft applications. AAI manufactures low-cost satellite systems and components, used in its own spacecraft and for spacecraft development in and outside the U.S. Note 7 - LONG -TERM BANK DEPOSITS AND LOAN December 31, ------------------------- 2003 2002 ---- ---- Deposits with bank for loans granted to employees (*) $ 1,901 $ 2,037 Other deposits with bank 53 935 Long-term loan - 714 ------- ------- $ 1,954 $ 3,686 ======= ======= (*) The deposits are linked to the Israeli CPI, bear annual interest of 4% and are presented net of current maturities of $633 (2002 - $680). -34- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 8 - PROPERTY, PLANT AND EQUIPMENT, NET December 31, -------------------------- 2003 2002 ---- ---- Land, buildings and leasehold improvements (2) $ 143,223 $ 128,456 Instruments, machinery and equipment (3) 194,129 169,467 Office furniture and other 24,943 21,904 Motor vehicles 29,776 24,393 --------- --------- 392,071 344,220 Accumulated depreciation (162,850) (141,259) --------- --------- Depreciated cost $ 229,221 $ 202,961 ========= ========= Depreciation expenses for the years ended December 31, 2003, 2002 and 2001 amounted to $30,775, $26,525 and $24,517, respectively. (1) Net of investment grants received (mainly for instruments, machinery and equipment) in the amounts of approximately $30,700 and $30,800 as of December 31, 2003 and 2002, respectively. (2) Includes, rights in approximately 9,225 square meters of land in, Tirat Hacarmel, Israel. The land is leased from the Israel Land Administration until the years 2014 to 2024 with a renewal option for additional periods of up to 49 years. The Company's rights in the land have not yet been registered in its name. Includes, rights in approximately 10,633 square meters of land in Rehovot, Israel. The land is leased from the Israel Land Administration until the year of 2043 with a renewal option for additional periods of up to 49 years. The Company's rights in the land have not yet been registered in its name. (3) Includes equipment produced by the Group for its own use in the amount of $10,498 and $5,517 as of December 31, 2003 and 2002, respectively. (4) As for pledges of assets - see Note 16(H). -35- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 9 - OTHER ASSETS, NET A. Weighted-average December 31, number of ----------------------- years 2003 2002 ----------------- ---- ---- Original cost: Know-how and technology (1) 12.5 $ 82,449 $ 81,398 Trade marks (2) 17 8,000 8,000 Goodwill (3) 37,613 37,199 --------- --------- 128,062 126,597 --------- --------- Accumulated amortization: Know-how and technology 21,555 14,666 Trade marks 1,458 1,125 Goodwill 5,037 5,037 --------- --------- 28,050 20,828 --------- --------- Amortized cost $ 100,012 $ 105,769 ========= ========= (1) Includes mainly know-how acquired in the merger with El-Op ($45,000), know-how acquired in the acquisition of AEL and the Government Division ($10,600) and intangible assets acquired from Honeywell Inc. ($9,300). (2) Includes trade marks acquired in the merger with El-Op. (3) Includes mainly goodwill acquired in the merger with El-Op ($34,200) and goodwill acquired from Honeywell Inc. ($1,800). Until January 1, 2002, goodwill was amortized at an annual rate of 5% - 10%. B. Amortization expenses amounted to $7,222, $6,412 and $8,348 for the years ended December 31, 2003, 2002 and 2001, respectively. C. The annual amortization expense relating to intangible assets existing as of December 31, 2003 for each of the five years in the period ending December 31, 2008 is estimated to be approximately $6,000. -36- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 9 - OTHER ASSETS, NET (CONT.) The following information is presented to reflect net income and net earnings per share for all prior periods adjusted to exclude amortization of goodwill. Year ended December 31, ------------ 2001 ------------ Reported net income $ 40,796 Goodwill amortization 2,760 -------- Adjusted net income $ 43,556 ======== Net earnings per share Reported basic net earnings per share $ 1.07 Goodwill amortization 0.08 -------- Adjusted basic net earnings per share $ 1.15 ======== Reported diluted net earnings per share $ 1.04 Goodwill amortization 0.07 -------- Adjusted diluted net earnings per share $ 1.11 ======== Note 10 - SHORT-TERM BANK CREDIT AND LOANS December 31, --------------------------------------- 2003 2002 2003 2002 ---- ---- ---- ---- Interest rate % ------------------ Short-term bank loans: In U.S. dollars 3.3-4.75 3-5 $ 533 $ 13,512 In EURO 3.5 - 1,927 - --------- --------- 2,460 13,512 --------- --------- Short-term bank credit: In NIS unlinked 7.2 9.6-10.9 4,684 5,241 In U.S. dollars 2.6 2.8-3.6 1,365 5,549 --------- --------- 6,049 10,790 --------- --------- $ 8,509 $ 24,302 ========= ========= The subsidiary in the U.S. maintains standby lines of credit with various banks. The sum of the lines equals $66,000 of which $15,900 was available as of December 31, 2003. As for liens - see Note 16F. -37- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 11 - OTHER PAYABLES AND ACCRUED EXEPNSES December 31, --------------------- 2003 2002 ---- ---- Payroll and related expenses $ 33,382 $ 27,912 Provision for vacation pay 25,280 20,492 Government departments 25,243 22,443 Provision for warranty 9,692 8,541 Cost provisions and others 62,930 61,916 ---------- ---------- $ 156,527 $ 141,304 ========== ========== Note 12 - CUSTOMERS ADVANCES AND AMOUNTS IN EXCESS OF COSTS INCURRED ON CONTRACTS IN PROGRESS December 31, --------------------- 2003 2002 ---- ---- Advances received $199,273 $225,160 Less - Advances presented under long-term liabilities 7,592 40,411 Advances deducted from inventories 77,482 67,624 -------- -------- 114,199 117,125 Less - Costs incurred on contracts in progress 14,581 10,658 -------- -------- $ 99,618 $106,467 ======== ======== As for guarantees see Note 16G -38- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 13 - LONG-TERM LOANS December 31, Interest Years of ----------------- Linkage % maturity 2003 2002 ------- -------- -------- ---- ---- Banks U.S. dollars Libor + 2004 - 2005 $57,574 $67,206 0.75%-1.85% Banks NIS-unlinked Israeli Prime 2004 - 2022 3,599 3,383 Office of chief NIS-linked to scientist the Israeli-CPI 5.2% 2004 - 2008 7,683 9,197 ------- ------- 68,856 79,786 Less-current maturities 6,818 6,613 ------- ------- $62,038 $73,173

======= ======= The Libor rate as of December 31, 2003 was 1.12%. The Israeli Prime rate as of December 31, 2003 was 6.3%. The maturities of these loans after December 31, 2003 are as follows: 2004 - current maturities $ 6,818 2005 56,136 2006 2,693 2007 139 2008 148 2009 and thereafter 2,922 ---------- $ 68,856 ========== In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees securing certain advances from customers, the Company and certain subsidiaries are obligated to meet certain loan covenants. Management believes that the Company and the subsidiaries meet the conditions of these covenants as of balance sheet date. As for charges see Note 16H. -39- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 14 - BENEFIT PLANS The subsidiary in the U.S. has adopted for its employees in the U.S. benefits plans as follows: Defined Benefit Retirement Plan The subsidiary in the U.S. has two defined benefit pension plans (the Plans) covering substantially its employees in the U.S. Monthly benefits are based on years of benefit service and annual compensation. Annual contributions to the Plans are determined using the unit credit actuarial cost method and are equal to or exceed the minimum required by law. Pension fund assets of the Plans are invested primarily in stock, bonds and cash by a financial institution, as the investment manager of the Plans' assets. The following table reconciles the benefit obligations, Plans assets, funded status and net asset (liability) information of the Plans: December 31, ----------------------- 2003 2002 ---- ---- Benefit obligation at beginning of year $ 28,439 $ 22,358 Service cost 2,480 2,067 Interest cost 1,921 1,678 Actuarial losses 2,825 2,955 Benefits repaid (700) (619) -------- -------- Benefit obligation at end of year 34,965 28,439 -------- -------- Plans assets at beginning of year 15,558 16,167 Actual return on Plan assets 2,689 (1,560) Contributions by employer 3,649 1,571 Benefits repaid (700) (619) -------- -------- Plans assets at end of year 21,196 15,559 -------- -------- Funded status of Plans (underfunded) (13,769) (12,880) Unrecognized prior service cost (195) 234 Unrecognized net actuarial loss 9,395 7,582 -------- -------- Net amount recognized (4,569) (5,064) ======== ======== Net asset (liability) consists of: Accrued benefit liability (11,011) (10,298) Intangible asset 51 234 Accumulated other comprehensive income 6,391 5,000 -------- -------- Net amount recognized (4,569) $ (5,064) ======== ======== Weighted average assumptions : Discount rate as of December 31, 6.25% 6.75% Expected long-term rate of return on Plans assets 9.00% 9.00% Rate of compensation increase 3.00% 3.00% -40- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 14 - BENEFIT PLANS (Cont.) Year ended December 31, ----------------------------- 2003 2002 2001 ---- ---- ---- Components of net periodic pension cost: Service cost $ 2,480 $ 2,067 $ 1,766 Interest cost 1,921 1,678 1,461 Expected return on Plan assets (1,573) (1,597) (1,666) Amortization of prior service cost (15) 28 24 Recognized of net actuarial gain 339 - (38) One-time FAS 88 charge for 2001 SRP - - 177 ------- -------- ------- Net periodic pension cost $ 3,152 $ 2,176 $ 1,724 ======= ======== ======= Defined Contribution Plan The 401(k) savings plan ("401(k) plan") is a defined contribution retirement plan that covers all eligible employees, as defined in section 401(k) of the U.S. Internal Revenue Code. Subsidiary's employees may elect to contribute a percentage of their annual gross compensation to the 401(k) plan. The U.S. subsidiary may make discretionary matching contributions as determined by the subsidiary. Total expense under the 401(k) plan amounted to $1,629 for the year ended December 31, 2003 (2002 - $1,369). -41- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 15 - TAXES ON INCOME A. APPLICABLE TAX LAWS (1) Measurement of taxable income under Israel's Income Tax (Inflationary Adjustments) Law, 1985: Results for tax purposes for the Company and certain of its Israeli subsidiaries are measured and reflected in accordance with the change in the Israeli Consumer Price Index ("CPI"). As explained above in Note 2B, the consolidated financial statements are presented in U.S. dollars. The differences between the change in the Israeli CPI and in the NIS/U.S. dollar exchange rate cause a difference between taxable income and the income before taxes reflected in the consolidated financial statements. In accordance with paragraph 9(f) of SFAS No. 109, the Company has not provided deferred income taxes on the above difference between the reporting currency and the tax basis of assets and liabilities. (2) Tax benefits under Israel's Law for the Encouragement of Industry (Taxes), 1969: The Company and certain subsidiaries in Israel (mainly El-Op and Cyclone) are "Industrial Companies", as defined by the Law for the Encouragement of Industry (Taxes), 1969, and as such, these companies are entitled to certain tax benefits, mainly amortization of costs relating to know-how and patents over eight years, accelerated depreciation and the right to deduct public issuance expenses for tax purposes. (3) Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1969: Several expansion programs of the Company and certain of its Israeli subsidiaries ("the companies") have been granted "Approved Enterprise" status under Israel's Law for the Encouragement of Capital Investments, 1959. For some expansion programs, the companies have elected the grants track and for others they have elected the alternative tax benefits track, waiving grants in return for tax exemptions. -42- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 15 - TAXES ON INCOME A. APPLICABLE TAX LAWS (CONT.) (3) Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1959 (cont.): Accordingly, certain income of the companies, derived from the "Approved Enterprise" expansion programs is tax exempt for two-year to ten-year period and subject to reduced tax rates of 25% for a five-year to eight-year period commencing in the year in which the companies had taxable income (limited to twelve years from commencement of production or fourteen years from the date of approval, whichever is earlier). As of December 31, 2003, the tax benefits for these expansion programs will expire between 2004 to 2010. The entitlement to the above benefits is subject to the companies fulfilling the conditions specified in the above referred law, regulations published there under and the letters of approval for the specific investments in "Approved Enterprises". In the event of failure to comply with these conditions, the benefits may be canceled and the companies may be required to refund the amount of the benefits, in whole or in part, including interest. (For liens - see Note 16F). As of December 31, 2003, Management believes that the companies are meeting all conditions of the approvals. The tax-exempt income attributable to the "Approved Enterprise" can be distributed to shareholders without imposing tax liability on the companies only upon the complete liquidation of the companies. As of December 31, 2003, retained earnings included approximately $96,000 in tax-exempt profits earned by the companies' "Approved Enterprise". If the retained tax-exempt income is distributed in a manner other than on the complete liquidation of the Company, it would be taxed at the corporate tax rate applicable to such profits as if the Company had not elected alternative tax benefits (currently - 25%) and an income tax liability would be incurred of approximately $ 23,940 as of December 31, 2003. -43- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 15 - TAXES ON INCOME A. APPLICABLE TAX LAWS (3) Tax benefits under Israel's Law for the Encouragement of Capital Investments, 1959: The Company's Board of Directors has decided that its policy is not to declare dividends out of such tax-exempt income. Accordingly, no deferred income taxes have been provided on income attributable to the Companyies "Approved Enterprise". In Israel, income from sources other than the "Approved Enterprise" during the benefit period will be subject to tax at the regular corporate tax rate of 36%. Since the companies are operating under more than one approval, and since part of their taxable income is not entitled to tax benefits under the abovementioned law and is taxed at the regular tax rate of 36%, the effective tax rate is the result of a weighted combination of the various applicable rates and tax exemptions, and the computation is made for income derived from each approval on the basis of formulas specified in the law and in the approvals. B. NON - ISRAELI SUBSIDIARIES Non-Israeli subsidiaries are taxed based on tax laws in their countries of residence (mainly in the U.S.). -44- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 15 - INCOME TAXES (CONT.) C. INCOME BEFORE TAXES ON INCOME Year ended December 31, --------------------------- 2003 2002 2001 ---- ---- ---- Income before taxes on income: Domestic $ 38,423 $ 42,317 $ 44,212 Foreign 11,090 11,977 7,638 -------- -------- -------- $ 49,513 $ 54,294 $ 51,850 ======== ======== ======== D. TAXES ON INCOME Year ended December 31, --------------------------- 2003 2002 2001 ---- ---- ---- Taxes on income: Current taxes: Domestic $ 12,346 $ 11,654 $ 9,385 Foreign 718 6,114 3,048 -------- -------- -------- $ 13,064 17,768 12,433 ======== ======== ======== Deferred income taxes: Domestic (4,672) (3,561) (839) Foreign 2,942 (2,059) (591) -------- -------- -------- (1,730) (5,620) (1,430) -------- -------- -------- Taxes in respect of prior years - (*)(2,800) - -------- -------- -------- $ 11,334 $ 9,348 $ 11,003 ======== ======== ======== (*) A reduction of tax expenses due to adjustments of estimated tax provision pursuant to the completion of prior years' tax assessments in respect of various Group companies. -45- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 15 - INCOME

TAXES (CONT.) E. DEFERRED INCOME TAXES Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of net deferred tax assets and liabilities are as follows: Deferred tax asset (liability)(1) ------------------------------ Total Current Noncurrent ----- ------- ---------- As of December 31, 2003 Deferred tax assets: Reserve and allowances $ 13,884 $ 13,922 $ (38) Inventory 7,547 7,547 - Net operating loss carryforwards 6,606 439 6,167 -------- -------- -------- 28,037 21,908 6,129 Valuation allowance (2) (3,879) - (3,879) -------- -------- -------- Net deferred tax assets 24,158 21,908 2,250 -------- -------- -------- Deferred tax liabilities: Property, plant and equipment (12,769) - (12,769) Other assets (14,397) - (14,397) -------- -------- -------- (27,166) - (27,166) -------- -------- -------- Net deferred tax assets (liabilities) $ (3,008) $ 21,908 $(24,916) ======== ======== ======== As of December 31, 2002 Deferred tax assets: Reserve and allowances $ 10,510 $ 10,859 $ (349) Inventory 9,138 9,138 - Net operating loss carryforwards 2,326 - 2,326 -------- -------- -------- 21,974 19,997 1,977 Valuation allowance (2) (2,326) - (2,326) -------- -------- -------- Net deferred tax assets 19,648 19,997 (349) -------- -------- -------- Deferred tax liabilities: Property, plant and equipment (9,209) - (9,209) Other assets (15,177) - (15,177) -------- -------- -------- (24,386) - (24,386) -------- -------- -------- Net deferred tax assets (liabilities) $ (4,738) $ 19,997 $(24,735) ======== ======== ======== -46- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 15 - INCOME TAXES (CONT.) E. DEFERRED INCOME TAXES (CONT.) (1) Current tax asset is included in other receivables. Noncurrent tax liability is included as a long-term liability. (2) During 2003, the Group increased the valuation allowance due to an increase in accumulated operating loss carryforwards that more likely than not, will not be utilized. F. The Group's Israeli subsidiaries have estimated total available carryforward tax losses of approximately $12,000 as of December 31, 2003. The Group's non-Israeli subsidiaries have estimated available carryforward tax losses of approximately $8,500 as of December 31, 2003 to offset against future taxable profits for an indefinite period. Deferred tax assets in respect of the above carryforward losses amount to approximately $6,600 in respect of which a valuation allowance has been recorded in the amount of approximately $3,900. G. Reconciliation of the theoretical tax expense, assuming all income is taxed at the statutory rate applicable to income of the Group, and the actual tax expense as reported in the statements of operations, is as follows: Year ended December 31, -- 2003 2002 2001 ---- ---- ---- Income before taxes as reported in the consolidated statements of operations $ 49,513 $ 54,294 $ 51,850 Statutory tax rate 36% 36% 36% ======== ======== ======== Theoretical tax expense $ 17,825 $ 19,546 $ 18,666 Tax benefit arising from reduced rate as an "Approved Enterprise" and other tax (8,391) (9,054) (7,697) benefits Tax adjustment in respect of different tax rate for foreign subsidiaries 279 (461) (952) Operating carryforward losses for which valuation allowance was provided 126 2,189 101 Increase (decrease) in taxes resulting from nondeductible expenses 993 (263) 571 Difference in basis of measurement for financial reporting and tax return purposes 846 458 832 Taxes in respect of prior years - (2,800) - Other differences, net (344) (267) (518) -------- -------- -------- Actual tax expenses $ 11,334 $ 9,348 $ 11,003 ======== ======== ======== Effective tax rate 22.9% 17.2% 21.2% ======== ======== ======== -47- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 16 - COMMITMENTS AND CONTINGENT LIABILITIES A. ROYALTY COMMITMENTS 1. The Company and certain Israeli subsidiaries partially finance their research and development expenditures under programs sponsored by the Office of the Chief Scientist in Israel ("OCS") for the support of research and development activities conducted in Israel. At the time the participations were received, successful development of the related projects was not assured. In exchange for participation in the programs by the OCS, the Company and the subsidiaries agreed to pay 2% - 5% of total sales of products developed within the framework of these programs. The royalties will be paid up to maximum amount equaling 100% to 150% of the grants provided by the OCS, linked to the dollar and for grants received after January 1, 1999, also bearing annual interest at a rate based on LIBOR and other applicable law. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, payment of royalties is not required. In some cases, the Government of Israel participation (through the OCS) is subject to export sales or other conditions. The maximum amount of royalties is increased in the event of production outside of Israel. The Company and certain of its subsidiaries are also obligated to pay certain amounts to the Israeli Ministry of Defense and others on certain sales including sales resulting from the development of certain technology.

Royalties expensed or accrued amounted to $7,812, $14,741 and $8,252 in 2003, 2002 and 2001, respectively. 2. In September 2001, the OCS issued "Regulations for the Encouragement of Research and Development in Industry" (rules for determining the level and payment of royalties) ("the regulations"). The regulations allow large R&D intensive companies to reach certain agreements with the OCS regarding determination of the amount and payment schedule of royalties, subject to certain conditions. -48- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 16 - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.) A. ROYALTY COMMITMENTS (CONT.) If the Company elects to adopt the regulations, it will have to record a significant one-time expense resulting from accruing a liability for an absolute amount of royalties. In May 2002, El-Op's Board of Directors approved an arrangement, proposed by the OCS, according to which El-Op pays commencing in 2002, an agreed amount of $10,632 in exchange for a release from all obligations to pay royalties in the future. As a result El-Op recorded an expense for the agreed amount net of the accrual for royalties previously recorded by El-Op in the amount of $9,801 included in Cost of Revenues. B. COMMITMENTS IN RESPECT OF LONG-TERM PROJECTS In connection with long-term projects in certain countries, the Company and certain subsidiaries undertook to use their respective best efforts to make or facilitate purchases or investments in those countries at certain percentages of the amount of the projects. The companies' obligation to make or facilitate third parties making such investments and purchases is subject to commercial conditions in the local market, typically without a specific financial penalty. The maximum aggregate undertaking as of December 31, 2003 amounted to $630,000 to be performed over a period of up to 11 years, is typically tied to a percentage (up to 100%) of the amount of the specific contract. In the opinion of Management, the actual amount of the investments and purchases is anticipated to be less than that mentioned above, since certain investments and purchases can result in reducing the overall undertaking on more than a one to one basis. -49- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 16 - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.) C. LEGAL CLAIMS The Company and its subsidiaries are involved in legal claims arising in the ordinary course of business, including claims by employees, consultants and others. Company's Management, based on the opinion of its legal counsel, believes that the financial impact for the settlement of such claims in excess of the accruals recorded in the financial statements will not have a material adverse effect on the financial position or results of operations of the Group. D. LEASE COMMITMENTS The future mininum lease commitments of the Group under various non-cancelable operating lease agreements in respect of premises, motor vehicles and office equipment are as of December 31, 2003: 2004 $ 8,520 2005 6,145 2006 5,557 2007 5,453 2008 and there after 5,451 -------- $ 31,126 ======== Rent expenses for the years ended December 31, 2003, 2002 and 2001 amounted to $9,177, $9,215, and $7,978, respectively. E. The Company has provided, on a proportional basis to its ownership interest, guarantees for two of its investees in respect of credit lines from banks amounting to $13,900 (2002- $10,600), of which $13,400 (2002 - $10,200) relates to a owned 50% foreign investee. The guarantees will exist as long as the credit lines are in effect. The Company would be liable to perform under the guarantee for any debt the investee would be in default under the terms of the credit line. F. A lien on the Group's Approved Enterprises has been registered in favor of the State of Israel. Grants received in respect of projects which have not yet been approved amount to approximately $800 (see Note 15 A (3) above). -50- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 16 - COMMITMENTS AND CONTINGENT LIABILITIES (CONT.) G. Guarantees in the amount of approximately $399,200 were issued by banks securing certain advances from customers and performance bonds on behalf of Group companies. H. Certain Group companies recorded fixed charges on most of their machinery and equipment, mortgages on most of their real estate and floating charges on most of their assets. Note 17 - SHAREHOLDER'S EQUITY A. SHARE CAPITAL Ordinary shares confer upon their holders voting rights, the right to receive dividends and the right to share in equity upon liquidation of the Company. B. 2000 EMPLOYEE STOCK OPTION PLAN In 2000, the Company adopted an employee stock option plan for employees comprising options to purchase up to 2,500,000 Ordinary shares. The exercise price approximates market price of the shares at the grant date. The plan includes an additional 2,500,000 options to be issued as "phantom" shares options that grant the option holders a number of shares reflecting the benefit component of the options exercised, as calculated at the exercise date, in consideration for their par value only. Options vest over a period of one to four years from the date of grant and expire no later than six years from the date of grant. Any options, which are canceled or forfeited before expiration, become available for future grants. As of December 31, 2003, 479,217 options of the Company were still available for future grants. C. "PHANTOM" SHARE OPTIONS The phantom share options are considered as part of a variable plan as defined in APB No. 25, and accordingly the compensation cost of the options is measured by the difference between the market price of the Company's shares and the exercise price of the options at the end of every reporting period and amortized by the accelerated method over the remaining vesting period. -51- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 17 - SHAREHOLDER'S EQUITY (CONT.) D. A summary of the Company's share option activity under the plans is as follows: December 31, --- 2003 2002 2001 -------------------------- ----------------------------- ----------------------------- Weighted Weighted Weighted average average average Number of exercise Number of exercise Number of exercise options price options price options price --------- --------- ------------- ---------- ---------- -------------- Outstanding-beginning of the year 4,511,724 $ 12.26 5,107,634 $ 11.93 5,671,918 $ 11.26 Granted 13,000 14.91 27,000 14.92 98,840 12.91 Exercised (757,947) 12.13 (558,901) 9.45 (598,348) 11.93 Forfeited (31,175) 12.29 (64,009) 11.33 (64,776) 12.50 --------- -------- --------- -------- --------- --------- Outstanding - end of the year 3,735,602 $ 12.30 4,511,724 $ 12.26 5,107,634 $ 11.93 ========= ======== ========= ======== ========= ========= Options exercisable at the end of the year 2,547,196 $ 12.23 2,287,790 $ 12.18 373,138 $ 7.56 ========= ======== ========= ======== ========= ========= E. The options outstanding as of December 31, 2003, have been separated into ranges of exercise price, as follows: Options outstanding Options exercisable --- ---------------------------- Number Weighted Weighted outstanding average Weighted Number average as of remaining average outstanding as exercise December 31, contractual exercise of December 31, price per Exercise price 2003 life (years) price per share 2003 share -------------- ------------ ----------- -------------- -------------- --------- $10.61-$12.16 158,935 0.42 $10.69 158,935 $10.69 $12.18-$15.64 1,786,193 2.93 12.37 1,190,240 12.34 $12.18-$15.64(*) 1,790,474 2.94 12.37 1,198,021 12.33 --------- ---- ------ --------- ------ 3,735,602 2.83 $12.30 2,547,196 $12.23 ========= ==== ====== ========= ====== (*) Phantom share options. -52- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 17 - SHAREHOLDER'S EQUITY (CONT.) E. (Cont.) Where the Company has recorded deferred stock compensation for options issued with an exercise price below the fair value of the Ordinary shares, the deferred stock compensation is amortized and recorded as compensation expense ratably over the vesting period of the options. Compensation expense (income) of $4,741, $(926) and $8,512 were recognized during the years ended December 31, 2003, 2002 and 2001, respectively. F. The weighted average exercise price and fair value of options granted during the years ended December 31, 2003, 2002 and 2001 were: Less than market price ------------------------------------- Year ended December 31, ------------------------------------- 2003 2002 2001 ---- ---- ---- Weighted-average exercise price $ 14.91 $ 14.92 $ 12.91 Weighted-average fair values on grant date $ 4.63 $ 4.31 $ 5.14 G. Computation of basic and diluted net earnings per share: Year ended Year ended Year ended December 31, 2003 December 31, 2002 December 31, 2001 ----------------------------------- --------------------------------- ----------------------------------- Net income Net income to Weighted to Weighted Net income to Weighted shareholders averaged Per shareholders averaged Per shareholders averaged Per of Ordinary number of share of Ordinary number of share of Ordinary number of share shares shares (*) amount shares shares (*) amount shares shares (*) amount ------------------------------------- ---------------------------------- ------------------------------------ Basic net earnings $ 45,945 39,061 $1.18 $45,113 38,489 $1.17 $40,796 37,975 $1.07 Effect of dilutive securities: Employee stock options - 1,169 - 1,374 - 1,384 ---------- ------ ------- ------ ------- ------ Diluted net earnings $ 45,945 40,230 $1.14 $45,113 39,863 $1.13 $40,796 39,359 $1.04 ========= ====== ===== ======= ====== ===== ======= ====== ===== * In thousands -53- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) --- U. S. dollars (In thousands) Note 17 - SHAREHOLDER'S EQUITY (CONT.) H. TREASURY SHARES The Company's shares held by the Company are presented at cost and deducted from shareholder's equity. I. DIVIDEND POLICY Dividends declared by the Company are paid in NIS or in foreign currency subject to any statutory limitations. The Company has decided not to declare dividends out of tax exempt earnings. Note 18 - MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION The Group adopted Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information", ("SFAS No. 131"). The Group operates in one reportable segment (see Note 1 for a brief description of the Group's business). A. Revenues are attributed to geographic areas based on location of the end customers as follows: Year ended December 31, ---------------------------------- 2003 2002 2001 ---- ---- ---- Europe $109,409 $144,862 $179,560 U.S. 332,323 267,686 206,627 Israel 255,742 225,674 226,650 Others 200,506 189,234 151,664 -------- -------- -------- $897,980 $827,456 $764,501 ======== ======== ======== B. Revenues are generated by the following product lines: Year ended December 31, ---------------------------------- 2003 2002 2001 ---- ---- ---- Airborne systems $373,580 $372,756 $334,201 Armored vehicles systems 199,800 135,700 126,300 Command, control, communications, computers and intelligence systems (C4I) 133,900 122,700 105,800 Electro-optical systems 140,500 148,200 162,700 Others 50,200 48,100 35,500 -------- -------- -------- $897,980 $827,456 $764,501 ======== ======== ======== C. Revenues from single customer, which exceed 10% of total revenues in the reported years: Year ended December 31, ---------------------------------- 2003 2002 2001 ---- ---- ---- Customer A 21% 18% 20% -54- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 18 - MAJOR CUSTOMER AND GEOGRAPHIC INFORMATION (CONT.) D. Long-lived assets by geographic areas: December 31, --------------------------------- 2003 2002 2001 ---- ---- ---- Israel $229,396 $211,256 $ 84,864 U.S 81,261 83,814 194,690 Others 18,093 13,660 10,451 -------- -------- -------- $328,750 $308,730 $290,005 ======== ======== ======== Note 19 - RESEARCH AND DEVELOPMENT COSTS, NET Year ended December 31, ------------------------------------- 2003 2002 2001 ---- ---- ---- Total expenses $ 65,487 $ 62,560 $ 67,871 Less - participations (10,568) (5,550) (9,112) -------- -------- -------- $ 54,919 $ 57,010 $ 58,759 ======== ======== ======== Note 20 - FINANCIAL EXPENSES, NET Year ended December 31, --------------------------------- 2003 2002 2001 ---- ---- ---- Expenses: On long-term bank debt $ 2,719 $ 2,026 $ 3,033 On short-term bank credit and loans 2,838 3,415 3,806 Others 5,600 1,214 798 ------- ------- ------- 11,157 6,655 7,637 ------- ------- ------- Income: Interest on cash, cash equivalents and bank deposits 309 1,547 2,179 Others 5,978 2,073 2,841 ------- ------- ------- 6,287 3,620 5,020 ------- ------- ------- $ 4,870 $ 3,035 $ 2,617 ======= ======= ======= -55- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 21 - OTHER INCOME (EXPENSES), NET Year ended December 31, ------------------------------- 2003 2002 2001 ---- ---- ---- Gain (loss) on sale of property plant and equipment $ 915 $(743) $ 327 Others, net (12) 281 447 ----- ----- ----- $ 903 $(462) $ 774 ===== ===== ===== Note 22 - RELATED PARTIES TRANSACTIONS AND BALANCES Year ended December 31, -------------------------------- 2003 2002 2001 ---- ---- ---- Income - Sales (*) $34,674 $37,924 $28,675 Expenses charged $ 1,773 $ 902 $ 633 Cost and expenses - Supplies and services $21,606 $10,457 $11,125 Participation in expenses (*) $ 1,751 $ 1,498 $ 1,632 Financial expenses $ 23 $ 110 $ 193 December 31, ----------------- 2003 2002 ---- ---- Trade receivables (*) $ 6,668 $ 9,647 Trade payables $ 4,975 $ 4,006 (*) The amounts relate mainly to transactions with VSI. Note 23 - RECONCILIATION TO ISRAELI GAAP As described in Note 2, the Company prepares its financial statements in accordance with U.S. GAAP. The effects of the differences between U.S. GAAP and Israeli GAAP on the Company's financial statements are detailed below. Differences between U.S. GAAP and Israeli GAAP: -56- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 23 - RECONCILIATION TO ISRAELI GAAP (CONT.) A building purchased from Elbit Ltd. ----------------------------------- According to generally accepted accounting principles in Israel ("Israeli GAAP"), the Company charged to capital reserves the excess of the amount paid over net book value of a building acquired from Elbit Ltd in 1999. According to U.S. GAAP, the entire amount paid is considered as the cost of the building acquired. Proportional consolidation method -------------------------------- According to Israeli GAAP, a jointly controlled company should be included according to the proportional consolidation method. According to U.S. GAAP, the investment in such a company is recorded according to the equity method. Tax benefit in respect of options exercised --- According to Israeli GAAP, tax benefits from employee options exercised are recorded as a reduction of tax expense. According to U.S. GAAP, the difference between the above mentioned tax benefits and the benefits recorded in respect of compensation expense in the financial statements is credited to capital reserves. Goodwill -------- Effective January 1, 2002, the Company adopted SFAS 142, "Goodwill and Other Intangible Assets" according to which goodwill and intangible assets with indefinite lives are no longer amortized periodically but are reviewed annually for impairment (or more frequently if impairment indicators arise). According to Israeli GAAP, all intangibles, including goodwill should be amortized. -57- ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.) -- U. S. dollars (In thousands) Note 23 - RECONCILIATION TO ISRAELI GAAP 1. Effect on net income and earnings per share Year ended December 31 ------------------------------------- 2003 2002 2001 ---- ---- ---- Net income as reported according to U.S. GAAP $ 45,945 $ 45,113 $ 40,796 Adjustments to Israeli GAAP 595 (4,227) 1,767 -------- -------- -------- Net income according to Israeli GAAP $ 46,540 $ 40,886 $ 42,563 ======== ======== ======== 2. Effect on shareholders' equity As per As reported Adjustments Israeli GAAP ----------- ----------- ------------ As of December 31, 2003 Shareholders' equity $452,079 $(10,367) $441,712 ======== ======== ======== As of December 31, 2002 Shareholders' equity $411,361 $(11,076) $400,285 ======== ======== ======== # # # # # # # # -58-