

Elbit Systems Ltd.
Management's Report
For The Quarter Ended June 30, 2008

This report should be read together with the unaudited financial statements for the quarter ended June 30, 2008 of Elbit Systems Ltd. ("Elbit Systems" and together with its subsidiaries, the "Company"), the Company's audited consolidated financial statements and related notes for the year ended December 31, 2007, the Company's management report for the year ended December 31, 2007 and the Company's Form 20-F for the year ended December 31, 2007, filed by the Company with the U.S. Securities and Exchange Commission and with the Israeli Securities Authority.

Forward looking statements with respect to the Company's business, financial condition and results of operations in this document are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward looking statements, including, but not limited to, product demand, pricing, market acceptance, changing economic conditions, governmental authorizations, risks in product and technology development, the effect of the Company's accounting policies as well as certain other risk factors which are detailed from time to time in the Company's SEC filings.

A. Executive Overview

Business Description

The Company operates in the areas of aerospace, land and naval systems, command, control, communications, computers, intelligence, surveillance and reconnaissance ("C⁴ISR"), unmanned air vehicles ("UAVs"), advanced electro-optic and space technologies, electronic warfare ("EW") suites, airborne warning systems, electronic intelligence ("ELINT") systems, data links, military communications systems and equipment and radios. The Company also focuses on the upgrading of existing military platforms and developing new technologies for defense, homeland security and commercial aviation applications.

The Company provides support services for the platforms it upgrades as well as the systems and products it supplies. In addition, the Company offers a wide range of logistic support services as well as advanced engineering and manufacturing services to various customers, utilizing its significant logistic and manufacturing capabilities. The Company often cooperates with industries in Israel and in various other countries.

The Company tailors and adapts its technologies, integration skills, market knowledge and battle-proven systems to each customer's individual requirements in both existing and new platforms. By upgrading existing platforms with advanced electronic and electro-optic technologies, the Company provides customers with cost-effective solutions, and its customers are able to improve their technological and operational capabilities within limited defense budgets.

The Company operates in a competitive environment for most of its projects, systems and products. Competition is based on product and program performance, price, reputation, reliability, maintenance costs and responsiveness to customer requirements. This includes the ability to respond to rapid changes in technology. In addition, its competitive position sometimes is affected by specific requirements in particular markets.

Financial Highlights

The Company's revenues increased by 39.5% and reached \$653.2 million in the second quarter of 2008, as compared to \$468.2 million in the second quarter of 2007.

The Company's backlog increased by 9.2% and reached \$5.05 billion as of June 30, 2008, as compared to \$4.62 billion as of December 31, 2007.

Net earnings in the second quarter of 2008 were \$31.2 million (4.8% of revenues) and diluted EPS was \$0.73, as compared to a \$0.7 million net loss in the second quarter of 2007, which included \$24.4 million In-Process Research & Development ("IPR&D") and restructuring costs net related to the acquisition of Tadiran Communications Ltd. ("Tadiran") in 2007.

The Company's cash flow generated from operations in the six months ended June 30, 2008 was \$129.8 million, as compared to \$129.7 million in the six months ended June 30, 2007.

The Board of Directors declared a dividend of \$0.20 per share for the second quarter of 2008.

B. Recent Events

- On May 21, 2008, the Company announced that its subsidiary, Elbit Systems Electro-Optics Elop Ltd. ("Elop") was recently awarded three contracts valued in a total amount of approximately \$87 million from a customer in Asia for the supply of cooled Thermal Imaging systems for reconnaissance and target acquisition applications. One of the contracts will be performed through Elbit Security Systems Ltd. The projects will be performed over two years and Elop foresees potential for follow-on orders.
- On July 1, 2008, the Company announced that all approvals required for the merger of Tadiran with and into Elbit Systems were obtained, and the Israeli Registrar of Companies issued its merger order on June 30, 2008. This is further to the announcement on November 7, 2007, regarding Elbit Systems Board of Directors' approval of the merger. Pursuant to the approved merger, Tadiran transferred all of its assets and liabilities to Elbit Systems, merged with and into Elbit Systems and no longer exists as a legal entity. The merger is part of Elbit Systems' re-organization plan. It included a merger and a vertical demerger of Elbit Systems' Land Systems and C4I Division together with most of the operations and activities of Tadiran in Israel prior to the merger into a wholly-owned Israeli subsidiary, Elbit Systems Land and C4I – Tadiran Ltd. The demerger occurred immediately after the approval of the merger and as an integral part thereof. In addition, Tadiran's former U.S. subsidiaries have become a part of the Elbit Systems of America companies.
- On July 2, 2008, the Company announced that on June 30, 2008, the court issued a series of orders relating to a trial in Memphis, Tennessee, against several defendants, including Kollsman, Inc. ("Kollsman"), a wholly-owned U.S. subsidiary of the Company. This is further to the Company's announcement on November 7, 2007 and information contained in the Company's Annual Report on Form 20-F filed on May 28, 2008 regarding a claim brought by the plaintiff Innovative Solutions and Support, Inc. The rulings reflect an award to the plaintiff against Kollsman for direct and exemplary damages, interest and costs totaling approximately \$23.2 million. A final judgment to be entered by the court will contain the actual judgment amounts. Kollsman strongly believes that these rulings are neither supported by the evidence on the record nor by the applicable law and intends to evaluate the options available to vigorously defend itself, including filing an appeal upon the entry of a final judgment in the case. The ruling impacted the Company's second quarter

2008 results in a net after tax amount of approximately \$10 million, taking into account reserves previously recorded.

- On July 24, 2008, the Company announced, further to the Company's announcement on July 4, 2007, that on July 22, 2008 the United States District Court for the Southern District of New York issued an order dismissing, on grounds of forum non conveniens, the claim filed last year by certain minority shareholders of ImageSat International N.V. ("ImageSat"). The Company, through one of its subsidiaries, holds a minority position in ImageSat. The claim had been filed against certain of ImageSat's shareholders including the Company and against certain current and former officers and directors of ImageSat, including among others Michael Federmann, Joseph Ackerman and Joseph Gaspar, the Company's Chairman, Chief Executive Officer and Chief Financial Officer, respectively. On July 28, 2008, the plaintiffs filed an appeal of the court's dismissal order with the U.S. Federal Court of Appeals for the Second Circuit. On August 6, 2008, another minority shareholder of ImageSat filed a similar claim in the New York District Court.
- On July 28, 2008, the Company announced that it anticipated an impact on its second quarter 2008 results of additional net after tax profit of approximately \$8-11 million, due mainly to a higher level of revenues generated from short-term delivery contracts in the quarter. Conversely, the Company noted, as indicated in its announcement on July 2, 2008, that its financial results for the second quarter are also negatively impacted in a net after tax amount of approximately \$10 million, as a result of a recent court ruling in the United States. Both developments are reflected in the Company's second quarter 2008 results.

C. Backlog of Orders

The Company's backlog of orders as of June 30, 2008 reached \$5,050 million, of which 71% were for orders outside of Israel. The Company's backlog as of December 31, 2007 was \$4,624 million, of which 70% were for orders outside of Israel.

Approximately 63% of the Company's backlog as of June 30, 2008 is scheduled to be performed in the following two quarters of 2008 and during 2009. The majority of the 37% balance is scheduled to be performed in 2010 and 2011.

D. Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 2 to the audited consolidated financial statements for the year ended December 31, 2007. See also the Company's management report for the year ended December 31, 2007.

In the first quarter of 2008, the Company adopted Statement of Financial Accounting Standards (FAS) 157, *Fair Value Measurements*, which defines fair value, establishes a market based framework or hierarchy for measuring fair value and expands disclosures about fair value measurements. FAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value, but does not require any new fair value measurements. The FAS 157 requirements for certain non-financial assets and liabilities have been deferred until the first quarter of 2009 in accordance with Financial Accounting Standards Board (FASB) Staff Position (FSP) 157-2. The adoption of FAS 157 did not have a material impact on the Company's results of operations, financial position or cash flows.

The fair-value hierarchy established in FAS 157 prioritizes the inputs used in valuation techniques into three levels as follows:

- A. Level 1 – Observable inputs – quoted prices in active markets for identical assets and liabilities;
- B. Level 2 – Observable inputs other than the quoted prices in active markets for identical assets and liabilities – includes quoted prices for similar instruments, quoted prices for identical or similar instruments in inactive markets, and amounts derived from valuation models where all significant inputs are observable in active markets; and
- C. Level 3 – Unobservable inputs – includes amounts derived from valuation models where one or more significant inputs are unobservable and are required in order to develop relevant assumptions.

The amount of assets and liabilities subject to the provision of SFAS 157 at June 30, 2008 includes mainly \$17.9 million of marketable securities and liabilities related to derivative financial instruments of \$19.8 million. The Company determined the fair values of the marketable securities using Level 3 methodology. Changes in the fair value of those securities, during the period, were recorded as follows: unrealized gains of \$0.5 million considered to be temporary were reflected in other comprehensive income, and unrealized loss of \$3.4 million that is considered to be other-than-temporary was charged to the statement of income as finance expenses. The fair value of the derivative financial instruments was determined using Level 2 methodology.

E. Recent Acquisitions

- On June 23, 2008, the Company's subsidiary Elbit Systems Electro-Optics Elop Ltd. ("Elop") acquired all of the shares of Bar-Kal Systems Engineering Ltd. ("Bar-Kal"), for a purchase price amount not material to the Company. Bar-Kal is an Israeli company, engaged in research, development and marketing of technologies related to systems engineering of hyperspectral remote sensing for defense and Government-related customers in Israel and abroad.
- On June 30, 2008, the Company acquired all of the shares of Electro Optic Research and Development Company Ltd. ("EORD") from their former shareholders, Technion Research & Development Foundation Ltd. and Bynet Electronics Ltd., for a purchase price amount not material to the Company. EORD is an Israeli company, engaged in research and development of acoustic and seismic sensors and systems for military and security applications.

F. Summary of Financial Results

The following table sets forth the consolidated statements of operations of the Company and its subsidiaries for the three and six-month periods ended June 30, 2008 and June 30, 2007. The financial statements of the Company in the six-month period ended June 30, 2008 include consolidation of 100% of Tadiran's financial results. In the first four months of 2007, 42% of Tadiran's results is included as equity in net earnings of affiliates companies and partnership, net of amortization. Commencing May 1, 2007, the results of Tadiran were consolidated in the Company's results.

	For the six months ended June 30				For the three months ended June 30			
	2008		2007		2008		2007	
	\$	%	\$	%	\$	%	\$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	1,269,230	100.0	871,758	100.0	653,167	100.0	468,158	100.0
Cost of revenues	903,474	71.2	641,266	73.6	455,764	69.8	341,204	72.9
Restructuring expenses	-	-	10,482	1.2	-	-	10,482	2.2
Gross profit	365,756	28.8	220,010	25.2	197,403	30.2	116,472	24.9
R&D expenses	92,489	7.3	66,207	7.6	46,583	7.1	36,508	7.8
Less – participation	(16,365)	(1.3)	(13,133)	(1.5)	(8,494)	(1.3)	(7,527)	(1.6)
R&D expenses, net	76,124	6.0	53,074	6.1	38,089	5.8	28,981	6.2
Marketing and selling expenses	103,303	8.1	71,577	8.2	53,639	8.2	39,206	8.4
General and administrative expenses	77,841	6.1	44,418	5.1	45,692	7.0	24,100	5.1
IPR&D write-off	-	-	16,560	1.9	-	-	16,560	3.5
	257,268	20.3	185,629	21.3	137,420	21.0	108,847	23.2
Operating income	108,488	8.5	34,381	3.9	59,983	9.2	7,625	1.6
Finance expenses, net	(16,973)	(1.3)	(7,962)	(0.9)	(12,373)	(1.9)	(5,034)	(1.1)
Other income (expenses), net	4,213	0.3	95	0.0	117	0.0	(18)	0.0
Income before taxes on income	95,728	7.5	26,514	3.0	47,727	7.3	2,573	0.5
Taxes on income	11,684	0.9	12,122	1.4	3,762	0.6	5,389	1.2
	84,044	6.6	14,392	1.6	43,965	6.7	(2,816)	(0.6)
Minority interest in gains of subsidiaries	(26,682)	(2.1)	(1,757)	(0.2)	(16,191)	(2.4)	(248)	(0.1)
Equity in net earnings of affiliated companies and partnership	5,946	0.5	5,773	0.7	3,381	0.5	2,373	0.5
Net earnings (loss)	<u>63,308</u>	<u>5.0</u>	<u>18,408</u>	<u>2.1</u>	<u>31,155</u>	<u>4.8</u>	<u>(691)</u>	<u>(0.1)</u>
Diluted earnings (loss) per share	<u>1.48</u>		<u>0.43</u>		<u>0.73</u>		<u>(0.02)</u>	

Revenues

The Company's sales are primarily to governmental entities and prime contractors under government defense programs. Accordingly, the level of the Company's revenues is subject to governmental budgetary constraints.

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

The consolidated revenues increased by 39.5% from \$468.2 million in the second quarter of 2007 to \$653.2 million in the second quarter of 2008.

The following table sets forth the Company's revenue distribution by areas of operation:

	Three-Month Period ended			
	June 30, 2008		June 30, 2007	
	\$ millions	%	\$ millions	%
Airborne systems	157.6	24.1	161.1	34.4
Land systems	153.4	23.5	68.5	14.6
C ⁴ ISR systems	216.2	33.1	136.7	29.2
Electro-optics	73.4	11.2	65.2	13.9
Other (mainly non-defense engineering and production services)	<u>52.6</u>	<u>8.1</u>	<u>36.7</u>	<u>7.9</u>
Total	<u>653.2</u>	<u>100.0</u>	<u>468.2</u>	<u>100.0</u>

The changes in revenue distribution by areas of operation were the result of quarterly fluctuations and the inclusion of Tadiran in the C⁴ISR area of operation. The increase in the Land systems area of operations is mainly related to growth in deliveries of products to the U.S. Government.

The following table sets forth the Company's distribution of revenues by geographical regions:

	Three-Month Period ended			
	June 30, 2008		June 30, 2007	
	\$ millions	%	\$ millions	%
Israel	103.7	15.9	77.0	16.5
United States	217.7	33.3	174.4	37.2
Europe	199.4	30.5	121.8	26.0
Other countries	<u>132.4</u>	<u>20.3</u>	<u>95.0</u>	<u>20.3</u>
Total	<u>653.2</u>	<u>100.0</u>	<u>468.2</u>	<u>100.0</u>

The changes in revenues by geographic distribution were the result of standard quarterly fluctuations and increased revenues to certain customers as mentioned above.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

The Company's consolidated revenues increased by 45.6%, from \$871.8 million in the first six months of 2007 to \$1,269.2 million in the first six months of 2008.

The following table sets forth the Company's revenue distribution by areas of operation:

	Six-Month Period ended			
	June 30, 2008		June 30, 2007	
	\$ millions	%	\$ millions	%
Airborne systems	312.8	24.6	312.8	35.9
Land systems	309.4	24.4	150.0	17.2
C ⁴ ISR systems	380.7	30.0	223.6	25.7
Electro-optics	161.5	12.7	117.6	13.5
Other (mainly non-defense engineering and production services)	<u>104.8</u>	<u>8.3</u>	<u>67.8</u>	<u>7.7</u>
Total	<u>1,269.2</u>	<u>100.0</u>	<u>871.8</u>	<u>100.0</u>

The changes in revenue distribution by areas of operation were the result of ordinary quarterly fluctuations and the inclusion of Tadiran in the C⁴ISR area of operation. The increase in the Land systems area of operations is mainly related to growth in deliveries of products to the U.S. Government.

The following table sets forth the Company's distribution of revenues by geographic regions:

	Six-Month Period ended			
	June 30, 2008		June 30, 2007	
	\$ millions	%	\$ millions	%
Israel	226.8	17.9	171.1	19.6
United States	432.8	34.1	325.3	37.3
Europe	336.6	26.5	205.6	23.6
Other countries	<u>273.2</u>	<u>21.5</u>	<u>169.8</u>	<u>19.5</u>
Total	<u>1,269.2</u>	<u>100.0</u>	<u>871.8</u>	<u>100.0</u>

The changes in revenues by geographic distribution were the result of ordinary quarterly fluctuations and revenues to customers as mentioned above.

Gross Profit

The Company's gross profit represents the aggregate results of the Company's activities and projects, and is based on the mix of programs in which the Company is engaged during the reported period.

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

Gross profit in the quarter ended June 30, 2008 was \$197.4 million as compared to \$116.5 million in the quarter ended June 30, 2007. The gross profit, in the second quarter of 2007, included restructuring expenses of \$10.5 million (which constituted 2.2% of revenues). As a result of these expenses, the gross profit margin in the second quarter of 2007 decreased to 24.9%, compared to a gross profit margin of 30.2% in the second quarter of 2008. The increase in the gross profit margin in the second quarter of 2008 was mainly as a result of higher level of profit margins in short-term delivery contracts and the mix of the projects sold.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

Gross profit in the six months ended June 30, 2008 was \$365.8 million as compared to \$220.0 million in the six months ended June 30, 2007. As a result of the expenses mentioned above (which constituted 1.2% of revenues), the gross profit margin in the six months ended June 30, 2007 decreased to 25.2%, compared to a gross profit margin of 28.8% in the six period ended June 30, 2008.

Research and Development (“R&D”)

The Company continually invests in R&D in order to maintain and further advance its technologies, in accordance with a long-term plan, based on its estimate of future market needs.

The Company’s R&D included programs which are partially funded by third parties, including the Israeli Ministry of Defense (“IMOD”), the Office of the Chief Scientist (“OCS”) and bi-national and European Development funds. The R&D was performed in all major areas of core technological activities of the Company and mainly in the areas of advanced airborne systems, cutting edge electro-optics technology and products for surveillance, aerial reconnaissance, lasers and space based sensors, communications, electronic warfare (EW) and homeland security technologies and products.

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

Gross R&D expenses in the quarter ended June 30, 2008 totaled \$46.6 million (7.1% of revenues), as compared to \$36.5 million (7.8% of revenues) in the quarter ended June 30, 2007.

Net R&D expenses (after deduction of third party participation) in the quarter ended June 30, 2008 totaled \$38.1 million (5.8% of revenues), as compared to \$29 million (6.2% of revenues) in the quarter ended June 30, 2007.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

Gross R&D expenses in the six months ended June 30, 2008 totaled \$92.5 million (7.3% of revenues), as compared to \$66.2 million (7.6% of revenues) in the six months ended June 30, 2007.

Net R&D expenses (after deduction of third party participation) in the six-month period ended June 30, 2008 totaled \$76.1 million (6.0% of revenues), as compared to \$53.1 million (6.1% of revenues) in the six-month period ended June 30, 2007.

Marketing and Selling Expenses

The Company maintains its activities in developing new markets and pursues at any given time various business opportunities according to the Company’s plan.

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

Marketing and selling expenses in the quarter ended June 30, 2008 were \$53.6 million (8.2% of revenues), as compared to \$39.2 million (8.4% of revenues) in the quarter ended June 30, 2007.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

Marketing and selling expenses in the six months ended June 30, 2008 were \$103.3 million (8.1% of revenues), as compared to \$71.6 million (8.2% of revenues) in the six months ended June 30, 2007.

General and Administrative (“G&A”) Expenses

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

G&A expenses were \$45.7 million (7.0% of revenues) in the quarter ended June 30, 2008, as compared to \$24.1 million (5.1% of revenues) in the quarter ended June 30, 2007. The increase in G&A expenses was mainly as a result of the court ruling against the Company’s U.S. subsidiary mentioned above.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

G&A expenses were \$77.8 million (6.1% of revenues) in the six months ended June 30, 2008, as compared to \$44.4 million (5.1% of revenues) in the six months ended June 30, 2007.

Operating Income

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

The Company’s operating income in the quarter ended June 30, 2008 was \$60 million, as compared to \$7.6 million in the quarter ended June 30, 2007. The operating income in 2007 was affected by restructuring expenses and an IPR&D write-off of \$27 million (which constituted 5.8% of revenues). As a result, the operating income margin in the second quarter of 2007 decreased to 1.6%, as compared to an operating margin of 9.2% in the second quarter of 2008. The higher level of operating margins in 2008 was a result of improved gross margins, mainly due to the higher level of short-term delivery contracts and mix of projects performed in the second quarter of 2008.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

The Company’s operating income in the six months ended June 30, 2008 was \$108.5 million, as compared to \$34.4 million in the six months ended June 30, 2007. As a result of the expenses mentioned above (which constituted 3.1% of revenues), the operating income margin in the six months ended June 30, 2007 decreased to 3.9%, as compared to 8.5% in the six months ended June 30, 2008.

Finance Expenses (Net)

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

Net finance expenses in the quarter ended June 30, 2008 were \$12.4 million, as compared to \$5.0 million in the quarter ended June 30, 2007. The net finance expenses in 2008 include the impact of a write-off relating to Auction Rate Securities in the amount of \$1.6 million and the effect of the revaluation of the New Israeli Shekel (“NIS”), which affected the Company’s activities and balances in NIS. As a result, the finance expenses margin in the second quarter of 2008 increased to 1.9%, as compared to 1.1% in the second quarter of 2007.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

Net finance expenses in the six months ended June 30, 2008 was \$17 million, as compared to \$8 million in the six months ended June 30, 2007. The net finance expenses in 2008 include the impact of a write-off relating to Auction Rate Securities in the amount of \$3.4 million and the effect of the revaluation of the NIS.

Taxes on Income

The Company's tax rate represents a weighted average of the tax rates to which the various Company entities are subject. The change in the effective tax rate is attributable mainly to the mix of the tax rates in the various tax jurisdictions in which the Company entities generating the taxable income operate. The increase in the weight average tax rates in the second quarter of 2007 was mainly due to the IPR&D write-off related to the acquisition of the Tadiran shares not being deductible for tax purposes

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

Provision for taxes in the quarter ended June 30, 2008 was \$3.8 million (effective tax rate of 7.9%), as compared to a provision for taxes of \$5.4 million (effective tax rate, excluding the IPR&D write-off, of 28.2%) in the quarter ended June 30, 2007.

Part of the tax rates decrease in the second quarter of 2008 was a result of lower level of profits generated in the U.S., in which the tax rates are higher. The lower profit was caused from the expenses related to the court ruling (see above).

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

Provision for taxes in the six months ended June 30, 2008 was \$11.7 million (effective tax rate of 12.2%), as compared to a provision for taxes of \$12.1 million (effective tax rate, excluding the IPR&D write-off, of 28.1%) in the six months ended June 30, 2007.

Minority Interest in Gains of Subsidiaries

The minority interest represents the minority part in gain/loss of subsidiaries, in which the Company holds less than 100%. The increase in 2008 is a result of higher level of sales and profit in those subsidiaries.

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

Minority interest in gain of subsidiaries in the quarter ended June 30, 2008 was \$16.2 million, as compared to \$0.3 million in the quarter ended June 30, 2007.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

Minority interest in gain of subsidiaries in the quarter ended June 30, 2008 was \$26.7 million, as compared to \$1.8 million in the quarter ended June 30, 2007.

Company's Share in Earnings of Affiliated Entities

The companies and partnerships, in which the Company holds 50% or less in shares or voting rights and are therefore not consolidated in its financial statements, operate in complementary areas to the Company's core business activities, including electro-optics and airborne systems.

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

In the second quarter of 2008, the Company had net income of \$3.4 million from its share in earnings of affiliated entities and partnership, as compared to \$2.4 million in the second quarter of 2007.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

In the six months ended June 30, 2008 the Company's share in earnings of affiliated companies and partnership was \$5.9 million, as compared to \$5.8 million in the six months ended June 30, 2007.

Net Earnings and Diluted Earnings Per Share ("EPS")

Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

Net earnings in the quarter ended June 30, 2008 were \$31.2 million (4.8% of revenues), and the diluted EPS was \$0.73.

The 2007 second quarter results included \$24.4 million of net IPR&D and restructuring expenses (\$0.57 per share). As a result, the second quarter of 2007 showed a loss of \$0.7 million and \$0.02 per share.

The number of shares used for computation of diluted EPS in the quarter ended June 30, 2008 was 42,868 thousand shares, as compared to 42,629 thousand shares in the quarter ended June 30, 2007.

Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

Net earnings in the six months ended June 30, 2008 were \$63.3 million (5.0% of revenues), as compared to net earnings of \$18.4 million, including the \$24.4 million IPR&D write-off and restructuring expenses, net, representing \$0.57 per share (2.1% of revenues) in the six months ended June 30, 2007. Diluted EPS in the six months ended June 30, 2008 was \$1.48, as compared to \$0.43 in the six months ended June 30, 2007.

The number of shares used for computation of diluted EPS in the six months ended June 30, 2008 was 42,872 thousand shares, as compared to 42,402 thousand shares in the six months ended June 30, 2007.

G. Liquidity and Capital Resources

The Company's net cash flow generated from operating activities in the six months ended June 30, 2008 was \$129.8 million, resulting mainly from net income and an increase in trade and other payables. The cash inflows were partially offset, mainly by an increase in inventories.

Net cash flow used for investment activities in the six months ended June 30, 2008 was \$91.7 million, which was used mainly for procurement of various assets and equipment and investments in short and long-term bank deposits.

Net cash flow used for financing activities in the six months ended June 30, 2008 was \$5.8 million, which was used mainly for dividend payment.

On June 30, 2008, the Company had total borrowings in the amount of \$470.2 million, including \$463.5 million in long-term loans, and \$942.2 million in guarantees issued on its behalf by banks, mainly in respect of advance payment and performance guarantees provided in the regular course of business. On June 30, 2008, the Company had a cash balance amounting to \$395.1 million.

As of June 30, 2008, the Company had working capital of \$274.7 million, and its current ratio was 1.21.

H. Derivatives and Hedges

Market risks relating to the Company's operations result primarily from changes in interest rates and exchange rates. The Company typically uses financial instruments to limit its exposure to those changes. The Company also typically enters into forward contracts in connection with transactions that are denominated in currencies other than U.S. dollars and NIS. The Company may enter from time to time into forward contracts related to NIS, based on market conditions.

On June 30, 2008, the Company's liquid assets were comprised of bank deposits, and it had no investments in liquid equity securities that were subject to market fluctuations, except for Auction Rate Securities (see Finance Expense (Net) above). The Company's deposits and loans are based on variable interest rates, and their value as of June 30, 2008 was therefore not exposed to changes in interest rates. Should interest rates either increase or decrease, such change may affect the Company's results of operations due to changes in the cost of the liabilities and the return on the assets that are based on variable rates.

The Company's functional currency is the U.S. dollar. On June 30, 2008, the Company had exposure due to liabilities denominated in NIS of \$222.7 million in excess of its NIS denominated assets. These liabilities represent mostly wages and trade payables. The amount of the Company's exposure to the changes in the NIS-U.S. dollar exchange rate varies from time to time and impacted the Company's finance expenses for the second quarter of 2008.

Most of the Company's assets and liabilities which are denominated in currencies other than the NIS and the U.S. dollar were covered as of June 30, 2008 by forward contracts. On June 30, 2008, the Company had forward contracts covering \$219.3 million in Euro, \$158.8 million in GBP and \$4.5 million in other currencies.

I. Dividends

The Board of Directors declared on August 11, 2008 a dividend of \$0.20 per share.

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