

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

This report should be read together with the unaudited financial statements for the quarter ended September 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 ("C<sup>4</sup>ISR"), 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 29.3% and reached \$671.2 million in the third quarter of 2008, as compared to \$518.9 million in the third quarter of 2007.

The Company's backlog increased by 5.4% and reached \$4.87 billion as of September 30, 2008, as compared to \$4.62 billion as of December 31, 2007.

Net earnings in the third quarter of 2008 were \$35.6 million and the diluted earnings per share were \$0.83, as compared to \$26.4 million and \$0.62 in the third quarter of 2007.

The Board of Directors declared a dividend of \$0.22 per share for the third quarter of 2008.

## **B. Recent Events**

- On August 20, 2008, the Company's subsidiary, Cyclone Aviation Products Ltd., was awarded a contract by The Boeing Company valued at approximately \$31 million to supply structural components for F-15 fighter jets. The contract calls for the supply of external fuel tanks, pylons, horizontal stabilizers and gun access doors. Deliveries are scheduled between 2009 and 2011.
- On September 1, 2008, the Company was awarded a contract to supply Hermes® 450 UAV systems to a country in the Americas for the total of approximately \$25 million. The contract also includes Skylark® I systems, all to be delivered within a year.
- On September 2, 2008, a settlement between Innovative Solutions and Support, Inc. ("IS&S") and the Company's U.S. subsidiary Kollsman, Inc. ("Kollsman") became effective with respect to all claims by IS&S and Kollsman against each other in the United States District Court for the Western District of Tennessee, and a corresponding Consent Order was entered. This is further to previous announcements by the Company regarding this litigation on November 7, 2007 and July 2, 2008. Under the settlement agreement, all claims between IS&S and Kollsman were dismissed with prejudice, a final agreed injunction was entered and the matter was fully and finally mutually settled without any admission of guilt by either party. In addition, an agreed settlement payment of \$17 million was made by Kollsman to IS&S. Kollsman and IS&S may explore opportunities for future business collaboration. As indicated in its announcement dated July 2, 2008, the Company's second quarter 2008 results reflected an approximately \$10 million net after tax write-off due to the impact of previous court rulings relating to the litigation. As a result of the settlement, the Company's third quarter 2008 results include a positive net after tax impact of approximately \$3 million.
- On October 22, 2008, the Company announced that it was recently awarded contracts valued in a total amount of approximately \$100 million, to supply its military communications systems to three armies. The communications systems to be delivered under the contracts are Tadiran CNR 9000, Tadiran HF 6000 and the PRC 710 radio systems. All products will be delivered through the end of 2009. Under the above-mentioned separate contracts, the Company will supply systems valued at approximately \$50 million, \$38 million and \$10 million to a South American, Asian and European country, respectively.

- On November 11, 2008, the Company was awarded a contract by Embraer, the Brazilian aircraft company, for the supply of avionics for the Brazilian AMX jet upgrade project. The initial development and prototype phase of the contract is in an amount of approximately \$67 million. The entire contract, including the subsequent production phase, is valued at approximately \$187 million and is scheduled to be completed through 2014. Implementation of the production phase following completion of the development and prototype phase is subject to further approval.

### **C. Backlog of Orders**

The Company's backlog of orders as of September 30, 2008 reached \$4,872 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 57% of the Company's backlog as of September 30, 2008 is scheduled to be performed in the last quarter of 2008 and during 2009. The majority of the 43% balance is scheduled to be performed in 2010 and 2011.

### **D. Critical Accounting Policies and Estimates**

- The significant accounting policies followed in the preparation of these statements are identical to those applied in preparation of the latest annual financial statements, except for the adoption of FASB Statement No. 157, "Fair Value Measurements", in accordance with Financial Accounting Standards Board (FASB) Staff Position (FSP) 157-2.
- Other new pronouncements issued but not effective as of September 30, 2008 are not expected to have a significant effect on the Company's consolidated financial position or results of operations, with the possible exception of the following, which are currently being evaluated by management:
  - (1) In March 2008, the FASB issued SFAS 161, "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161). SFAS 161 is an amendment of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). To address concerns that the existing disclosure requirements of SFAS 133 do not provide adequate information, SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. SFAS 161 will be effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the future impacts and disclosures resulting from SFAS 161.
  - (2) In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP. It is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles". The Company is currently evaluating the impact of SFAS No. 162 on its financial statements, and the adoption of this statement is not expected to have a material effect on the Company's financial statements.

- (3) In October, 2008, the FASB issued FSP No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" (FSP 157-3). FSP 157-3 clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate following the guidance in FASB Statement No. 154, "Accounting Changes and Error Corrections" (SFAS 154). However, the disclosure provisions in SFAS 154 for a change in accounting estimate are not required for revisions resulting from a change in valuation technique or its application. The adoption of FSP 157-3 did not have a material impact on the Company's financial position or results of operations.

#### **E. Recent Acquisitions**

- On October 27, 2008, the Company signed an agreement (the "Purchase Agreement") to purchase a minority interest in Azimuth Technologies Ltd. ("Azimuth"). Azimuth is an Israeli company whose shares are traded on the Tel Aviv Stock Exchange ("TASE") and is engaged in the development and sale of products for target acquisition, navigation and orientation for the defense market. Under the Purchase Agreement, the Company purchased from certain minority shareholders of Azimuth 13,739,400 shares, representing approximately 19.48% of Azimuth's voting shares on a non-fully diluted basis, for a price of \$0.25 (twenty-five cents) per share. The purchase was completed on November 12, 2008. The investment in Azimuth will be accounted for on a cost basis.
- On November 11, 2008, the Company's U.S. subsidiary Elbit Systems of America, LLC, acquired all of the shares of Innovative Concepts, Inc. ("ICI") from Herley Industries, Inc. in a \$15 million all cash transaction. ICI, located in McLean, Virginia, is a wireless communications technology firm specializing in design, production and support of real-time embedded systems and high-speed processing solutions for defense and homeland security applications. ICI became part of Elbit Systems of America's C4I Solutions business. This acquisition is part of Elbit Systems of America's strategy to provide advanced C4I systems solutions to the United States Department of Defense and Department of Homeland Security. The results of ICI will be consolidated in the Company's financial statements commencing the date of acquisition. The Company is in the process of preparing a Purchase Price Allocation related to the acquisition.

## 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 nine-month periods ended September 30, 2008 and September 30, 2007. The financial statements of the Company in the nine-month period ended September 30, 2008 include consolidation of 100% of Tadiran Communication Ltd.'s ("Tadiran") and Ferranti Technologies (Group) Limited ("FTL") financial results. The financial statements of the Company for the nine-month period ended September 30, 2007 include consolidation of Tadiran's financial results from May 2007, and the financial results of FTL from August 2007.

	For the nine months ended September 30				For the three months ended September 30			
	2008		2007		2008		2007	
	\$	%	\$	%	\$	%	\$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	<b>1,940,417</b>	100.0	<b>1,390,705</b>	100.0	<b>671,187</b>	100.0	<b>518,947</b>	100.0
Cost of revenues	<b>1,376,334</b>	70.9	<b>1,020,022</b>	73.3	<b>472,860</b>	70.5	<b>378,755</b>	73.0
Restructuring expenses	<u>-</u>	-	<u>10,482</u>	0.8	<u>-</u>	-	<u>-</u>	-
Gross profit	<u><b>564,083</b></u>	29.1	<u><b>360,201</b></u>	25.9	<u><b>198,327</b></u>	29.5	<u><b>140,192</b></u>	27.0
R&D expenses	<b>145,261</b>	7.5	<b>106,019</b>	7.6	<b>52,772</b>	7.9	<b>39,812</b>	7.7
Less – participation	<u><b>(24,152)</b></u>	(1.2)	<u><b>(18,425)</b></u>	(1.3)	<u><b>(7,787)</b></u>	(1.2)	<u><b>(5,292)</b></u>	(1.0)
R&D expenses, net	<b>121,109</b>	6.3	<b>87,594</b>	6.3	<b>44,985</b>	6.7	<b>34,520</b>	6.7
Marketing and selling expenses	<b>152,754</b>	7.9	<b>113,134</b>	8.1	<b>49,451</b>	7.4	<b>41,558</b>	8.0
General and administrative expenses	<b>103,399</b>	5.3	<b>73,182</b>	5.3	<b>25,558</b>	3.8	<b>28,764</b>	5.5
IPR&D write-off	<u>-</u>	-	<u>16,560</u>	1.2	<u>-</u>	-	<u>-</u>	-
	<u><b>377,262</b></u>	19.5	<u><b>290,470</b></u>	20.9	<u><b>119,994</b></u>	17.9	<u><b>104,842</b></u>	20.2
Operating income	<b>186,821</b>	9.6	<b>69,731</b>	5.0	<b>78,333</b>	11.6	<b>35,350</b>	6.8
Finance expenses, net	<b>(33,056)</b>	(1.7)	<b>(8,698)</b>	(0.6)	<b>(16,083)</b>	(2.3)	<b>(736)</b>	(0.1)
Other income (expenses), net	<u><b>4,230</b></u>	0.2	<u><b>82</b></u>	-	<u><b>17</b></u>	0.0	<u><b>(13)</b></u>	-
Income before taxes on income	<b>157,995</b>	8.1	<b>61,115</b>	4.4	<b>62,267</b>	9.3	<b>34,601</b>	6.7
Taxes on income	<u><b>28,089</b></u>	1.4	<u><b>21,311</b></u>	1.5	<u><b>16,405</b></u>	2.5	<u><b>9,189</b></u>	1.8
	<b>129,906</b>	6.7	<b>39,804</b>	2.9	<b>45,862</b>	6.8	<b>25,412</b>	4.9
Minority interest in gains of subsidiaries	<b>(39,073)</b>	(2.0)	<b>(5,042)</b>	(0.4)	<b>(12,391)</b>	(1.8)	<b>(3,285)</b>	(0.6)
Equity in net earnings of affiliated companies and partnership	<u><b>8,071</b></u>	0.4	<u><b>10,021</b></u>	0.7	<u><b>2,125</b></u>	0.3	<u><b>4,248</b></u>	0.8
Net earnings	<u><b>98,904</b></u>	<u>5.1</u>	<u><b>44,783</b></u>	<u>3.2</u>	<u><b>35,596</b></u>	<u>5.3</u>	<u><b>26,375</b></u>	<u>5.1</u>
Diluted earnings per share	<u><b>2.31</b></u>		<u><b>1.06</b></u>		<u><b>0.83</b></u>		<u><b>0.62</b></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 September 30, 2008, Compared to Three Months Ended September 30, 2007

The consolidated revenues increased by 29.3% from \$518.9 million in the third quarter of 2007 to \$671.2 million in the third quarter of 2008.

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

	Three-Month Period ended			
	September 30, 2008		September 30, 2007	
	\$ millions	%	\$ millions	%
Airborne systems	161.7	24.1	136.5	26.3
Land systems	122.7	18.3	94.1	18.1
C <sup>4</sup> ISR systems	297.8	44.3	192.0	37.0
Electro-optics	63.7	9.5	61.0	11.8
Other (mainly non-defense engineering and production services)	<u>25.3</u>	<u>3.8</u>	<u>35.3</u>	<u>6.8</u>
Total	<u>671.2</u>	<u>100.0</u>	<u>518.9</u>	<u>100.0</u>

The changes in revenue distribution by areas of operation were the result of quarterly fluctuations. The increase in C<sup>4</sup>ISR systems is mainly as a result of UAV systems projects sold to European customers.

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

	Three-Month Period ended			
	September 30, 2008		September 30, 2007	
	\$ millions	%	\$ millions	%
Israel	131.8	19.6	119.1	23.0
United States	221.4	33.0	169.6	32.7
Europe	157.8	23.5	131.3	25.3
Other countries	<u>160.2</u>	<u>23.9</u>	<u>98.9</u>	<u>19.0</u>
Total	<u>671.2</u>	<u>100.0</u>	<u>518.9</u>	<u>100.0</u>

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

### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

The Company's consolidated revenues increased by 39.5%, from \$1,390.7 million in the first nine months of 2007 to \$1,940.4 million in the first nine months of 2008.

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

	Nine-Month Period ended			
	September 30, 2008		September 30, 2007	
	\$ millions	%	\$ millions	%
Airborne systems	474.5	24.5	449.3	32.3
Land systems	432.0	22.2	244.1	17.6
C <sup>4</sup> ISR systems	714.3	36.8	415.6	29.9
Electro-optics	225.3	11.6	178.6	12.8
Other (mainly non-defense engineering and production services)	<u>94.3</u>	<u>4.9</u>	<u>103.1</u>	<u>7.4</u>
Total	<u>1,940.4</u>	<u>100.0</u>	<u>1,390.7</u>	<u>100.0</u>

The changes in revenue distribution by areas of operation were the result of ordinary quarterly fluctuations. The increase in the C<sup>4</sup>ISR systems area of operations is mainly as a result of the inclusion of Tadiran in the C<sup>4</sup>ISR area of operation and UAV systems projects sold to European customers. 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:

	Nine-Month Period ended			
	September 30, 2008		September 30, 2007	
	\$ millions	%	\$ millions	%
Israel	358.6	18.5	290.3	20.9
United States	654.2	33.7	494.9	35.6
Europe	494.3	25.5	336.8	24.2
Other countries	<u>433.3</u>	<u>22.3</u>	<u>268.7</u>	<u>19.3</u>
Total	<u>1,940.4</u>	<u>100.0</u>	<u>1,390.7</u>	<u>100.0</u>

The changes in revenues by geographic distribution were the result of ordinary quarterly fluctuations and revenues from 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 September 30, 2008, Compared to Three Months Ended September 30, 2007**

Gross profit in the quarter ended September 30, 2008 was \$198.3 million as compared to \$140.2 million in the quarter ended September 30, 2007. The gross profit margin in the third quarter of 2007 was 29.5% as compared to 27.0% in the same period last year. The increase in the gross profit margin in the third 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.

### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Gross profit in the nine months ended September 30, 2008 was \$564.1 million as compared to \$360.2 million in the nine months ended September 30, 2007. As a result of the restructuring expenses of \$10.5 million related to the acquisition of Tadiran in the second quarter of 2007 (which constituted 0.8% of revenues), the gross profit margin in the nine months ended September 30, 2007 was 25.9%, compared to a gross profit margin of 29.1% in the nine-month period ended September 30, 2008. The increase in the gross profit margin in the nine months ended September 30, 2008 was mainly as a result of higher level of profit margins in short-term delivery contracts and the mix of the projects sold.

### **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, EW and homeland security technologies and products.

### Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Gross R&D expenses in the quarter ended September 30, 2008 totaled \$52.8 million (7.9% of revenues), as compared to \$39.8 million (7.7% of revenues) in the quarter ended September 30, 2007.

Net R&D expenses (after deduction of third party participation) in the quarter ended September 30, 2008 totaled \$45.0 million (6.7% of revenues), as compared to \$34.5 million (6.7% of revenues) in the quarter ended September 30, 2007.

### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Gross R&D expenses in the nine months ended September 30, 2008 totaled \$145.3 million (7.5% of revenues), as compared to \$106.0 million (7.6% of revenues) in the nine months ended September 30, 2007.

Net R&D expenses (after deduction of third party participation) in the nine-month period ended September 30, 2008 totaled \$121.1 million (6.3% of revenues), as compared to \$87.6 million (6.3% of revenues) in the nine-month period ended September 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 September 30, 2008, Compared to Three Months Ended September 30, 2007

Marketing and selling expenses in the quarter ended September 30, 2008 were \$49.5 million (7.4% of revenues), as compared to \$41.6 million (8.0% of revenues) in the quarter ended September 30, 2007.

### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Marketing and selling expenses in the nine months ended September 30, 2008 were \$152.8 million (7.9% of revenues), as compared to \$113.1 million (8.1% of revenues) in the nine months ended September 30, 2007.

### **General and Administrative (“G&A”) Expenses**

#### Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

G&A expenses were \$25.6 million (3.8% of revenues) in the quarter ended September 30, 2008, as compared to \$28.8 million (5.5% of revenues) in the quarter ended September 30, 2007. The decrease in G&A expenses in the third quarter of 2008 was mainly as a result of the settlement between IS&S and Kollsman.

#### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

G&A expenses were \$103.4 million (5.3% of revenues) in the nine months ended September 30, 2008, as compared to \$73.2 million (5.3% of revenues) in the nine months ended September 30, 2007. The increase in the total amount of G&A expenses was mainly a result of the settlement mentioned above.

### **Operating Income**

#### Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

The Company’s operating income in the quarter ended September 30, 2008 was \$78.3 million, as compared to \$35.4 million in the quarter ended September 30, 2007.

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 third quarter of 2008.

#### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

The Company’s operating income in the nine months ended September 30, 2008 was \$186.8 million, as compared to \$69.7 million in the nine months ended September 30, 2007. The operating income in 2007 was affected by restructuring expenses and an IPR&D write-off of \$27 million (which constituted 1.94% of revenues). As a result, the operating income margin in the nine-month period ended September 30, 2007 was 5.0%, as compared to an operating margin of 9.6% in the nine-month period ended September 30, 2008.

## **Finance Expenses (Net)**

### **Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007**

Net finance expenses in the quarter ended September 30, 2008 were \$16.1 million, as compared to \$0.7 million in the quarter ended September 30, 2007. The net finance expenses in 2008 include the impact of a write-off relating to Auction Rate Securities in the amount of \$5.7 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 third quarter of 2008 increased to 2.3% as compared to 0.1% in the third quarter of 2007.

### **Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007**

Net finance expenses in the nine months ended September 30, 2008 was \$33.1 million, as compared to \$8.7 million in the nine months ended September 30, 2007. The net finance expenses in 2008 include the impact of a write-off relating to Auction Rate Securities in the amount of \$9.1 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.

### **Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007**

Provision for taxes in the quarter ended September 30, 2008 was \$16.4 million (effective tax rate of 26.3%), as compared to a provision for taxes of \$9.2 million (effective tax rate of 26.6%) in the quarter ended September 30, 2007.

### **Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007**

Provision for taxes in the nine months ended September 30, 2008 was \$28.1 million (effective tax rate of 17.8%), as compared to a provision for taxes of \$21.3 million (effective tax rate of 34.9%) in the nine months ended September 30, 2007. The higher weighted average effective tax rate in the nine months ended September 30, 2007 was effected by the IPR&D write-off related to the acquisition of the Tadiran shares not being deductible for tax purposes (excluding the IPR&D write-off, the effective tax rate in 2007 was 27.2%).

## **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 levels of sales and profit in those subsidiaries.

### **Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007**

Minority interest in gain of subsidiaries in the quarter ended September 30, 2008 was \$12.4 million, as compared to \$3.3 million in the quarter ended September 30, 2007.

#### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Minority interest in gain of subsidiaries in the nine months ended September 30, 2008 was \$39.1 million, as compared to \$5.0 million in the nine months ended September 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 September 30, 2008, Compared to Three Months Ended September 30, 2007

In the third quarter of 2008, the Company had net income of \$2.1 million from its share in earnings of affiliated entities and partnership, as compared to \$4.2 million in the third quarter of 2007.

#### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

In the nine months ended September 30, 2008 the Company's share in earnings of affiliated companies and partnership was \$8.1 million, as compared to \$10.0 million in the nine months ended September 30, 2007.

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

#### Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Net earnings in the quarter ended September 30, 2008 were \$35.6 million (5.3% of revenues), as compared to net earnings of \$26.4 million (5.1% of revenues) in the quarter ended September 30, 2007. Diluted EPS in the quarter ended September 30, 2008 was \$0.83, as compared to \$0.62 in the quarter ended September 30, 2007.

The number of shares used for computation of diluted EPS in the quarter ended September 30, 2008 was 42,813 thousand shares, as compared to 42,307 thousand shares in the quarter ended September 30, 2007.

#### Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Net earnings in the nine months ended September 30, 2008 were \$98.9 million (5.1% of revenues), as compared to net earnings of \$44.8 million, including the \$24.4 million IPR&D write-off and restructuring expenses, net, representing \$0.57 per share (1.8% of revenues) in the nine months ended September 30, 2007. Diluted EPS in the nine months ended September 30, 2008 was \$2.31, as compared to \$1.06 in the nine months ended September 30, 2007.

The number of shares used for computation of diluted EPS in the nine months ended September 30, 2008 was 42,852 thousand shares, as compared to 42,372 thousand shares in the nine months ended September 30, 2007.

## **G. Liquidity and Capital Resources**

The Company's net cash flow generated from operating activities in the nine months ended September 30, 2008 was \$112.9 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 and a decrease in advances received from customers.

Net cash flow used for investment activities in the nine months ended September 30, 2008 was \$116.6 million, which was used mainly for procurement of various assets and equipment.

Net cash flow used for financing activities in the nine months ended September 30, 2008 was \$88.5 million, which was used mainly for repayment of long-term bank loans and dividend payments.

On September 30, 2008, the Company had total borrowings in the amount of \$396 million, including \$382.9 million in long-term loans, and \$903.3 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 September 30, 2008, the Company had a cash balance amounting to \$270.6 million.

As of September 30, 2008, the Company had working capital of \$260.5 million, and its current ratio was 1.22.

## **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 exchange rate 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 September 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 September 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 September 30, 2008, the Company had exposure due to liabilities denominated in NIS of \$128.2 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 third quarter and the nine months ended September 30, 2008.

Most of the Company's assets and liabilities that are denominated in currencies other than the NIS and the U.S. dollar were covered as of September 30, 2008 by forward contracts. On September

30, 2008, the Company had forward contracts covering \$192 million in Euro, \$115 million in GBP and \$4.8 million in other currencies.

On September 30, 2008, the Company had options and forward contracts for hedging future cash flow denominated in NIS in the amount of \$286 million. The fair market value of the options and the forward contracts as of September 30, 2008 was an unrealized gain of approximately \$1.5 million.

**I. Dividends**

The Board of Directors declared on November 24, 2008 a dividend of \$0.22 per share.

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