ELBIT SYSTEMS LTD
Form 6-K
July 06, 2007

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

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# FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16
Under the Securities Exchange Act of 1934
For the Month of July 2007

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Commission File Number: 000-28998

**ELBIT SYSTEMS LTD.**
(Translation of Registrant s Name into English)
Advanced Technology Center, P.O.B. 539, Haifa 31053, Israel
(Address of Principal Corporate Offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

**Note**: Regulation S-T Rule 101(b)(1) only permits the submission in paper of a Form 6-K if submitted solely to provide an attached annual report to security holders.

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

**Note**: Regulation S-T Rule 101(b)(7) only permits the submission in paper of a Form 6-K submitted to furnish a report or other document that the registrant foreign private issuer must furnish and make public under the laws of the jurisdiction in which the registrant is incorporated, domiciled or legally organized (the registrant s home country ), or under the rules of the home country exchange on which the registrant s securities are traded, as long as the report or other document is not a press release, is not required to be and has not been distributed to the registrant s security holders, and, if discussing a material event, has already been the subject of a Form 6-K submission or other Commission filing on EDGAR.

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes No

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82-______________

Attached hereto as Exhibit 1 and incorporated by reference herein is the Registrant s Proxy Statement, mailed to the Registrant s shareholders on or about July 6, 2007.

Attached hereto as Exhibit 2 and incorporated by reference herein is the Registrant s proxy card, mailed to the Registrant s shareholders on or about July 6, 2007.

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ELBIT SYSTEMS LTD.**
(Registrant)

By: /s/ Yaniv Baram
Name: Yaniv Baram
Title: Corporate Secretary

Dated: July 6, 2007

**EXHIBIT INDEX**

| **Exhibit No.** | **Description** |
|---|---|
| 1. | Proxy Statement |
| 2. | Proxy Card |

Exhibit 1

July 6, 2007

Dear Fellow Shareholder,

You are cordially invited to attend the Elbit Systems Ltd. Annual General Meeting of Shareholders to be held at 3:00 p.m. local time on Monday, August 13, 2007, at our offices at Advanced Technology Center, Haifa, Israel.

The agenda of the meeting and the proposals to be voted on are described in the accompanying proxy statement. For the reasons described in the proxy statement, the Board of Directors recommends that you vote FOR Items 1 and 2 as specified on the enclosed proxy card.

At the meeting, management also will present the other matters described in the proxy statement and provide a discussion period for questions and comments of general interest to shareholders.

We look forward to greeting all the shareholders who will be present at the meeting. However, whether or not you are able to attend, it is important that your shares be represented. Therefore, at your earliest convenience, please sign, date and mail the enclosed proxy card in the envelope provided so that it is received not later than 24 hours before the meeting.

Thank you for your cooperation.

Very truly yours,

/s/ Michael Federmann

MICHAEL FEDERMANN
Chairman of the Board of Directors

/s/ Joseph Ackerman

JOSEPH ACKERMAN
President and Chief Executive Officer

**ELBIT SYSTEMS LTD.**

**NOTICE OF ANNUAL GENERAL MEETING OF SHAREHOLDERS**

Haifa, Israel
July 6, 2007

This is notice that the Annual General Meeting of Shareholders of Elbit Systems Ltd. (the Company ) will be held at the Company s offices at the Advanced Technology Center, Haifa, Israel, on Monday, August 13, 2007, at 3:00 p.m. local time, for the following purposes:

1. to elect seven directors to the Company s Board of Directors; and

2. to re-appoint the Company s independent auditors for the fiscal year ending December 31, 2007.

In addition, at the meeting the Company will present the Management Report, the Auditors Report and the Consolidated Financial Statements of the Company, each for the fiscal year ended December 31, 2006. The Company also will report on the dividend, directors compensation and independent auditors compensation arrangement with respect to fiscal year 2006.

Shareholders of record at the close of business on July 11, 2007, are entitled to receive notice of, and to vote at, the meeting. All shareholders are cordially invited to attend the meeting in person.

Shareholders who are unable to attend the meeting in person are requested to complete, date and sign the enclosed proxy card and return it promptly in the pre-addressed envelope provided so that it is received by the Company at least 24 hours before the meeting. No postage is required if mailed in the United States. Shareholders who attend the meeting may revoke their proxies and vote their shares in person.

By Order of the Board of Directors,

/s/ Michael Federmann

MICHAEL FEDERMANN
Chairman of the Board of Directors

/s/ Joseph Ackerman

JOSEPH ACKERMAN
President and Chief Executive Officer

**The Company s Financial Statements for the fiscal year ended December 31, 2006, are enclosed but are not a part of this proxy. The Financial Statements should not be considered as proxy solicitation material.**

**QUESTIONS AND ANSWERS ABOUT THE ANNUAL GENERAL MEETING**

***The following questions and answers summarize the major issues to be discussed at the Annual General Meeting. For a more complete description of the issues please see the accompanying Proxy Statement.***

**Q: When and where is the Meeting?**

A: The Meeting will take place at 3:00 p.m. local time, on Monday, August 13, 2007, at the Company's offices at the Advanced Technology Center, Haifa, Israel.

the compensation paid to the Company's directors; and

the compensation arrangement with the Company's independent auditors.

**Q: What do I need to do now?**

**Q: What is the record date for the Meeting?**

A: The record date is July 11, 2007, and all shareholders holding shares it in at the close of business on July 11, 2007 will be entitled to receive notice of and to vote at the Meeting.

**Q: What are the items to be voted on at the Meeting?**

A: The items to be voted on include:

- Election of seven directors to the Board of Directors;
- Appointment of the Company's independent auditors for 2007.

**Q: Does the Company and its Board of Directors support the proposals to be voted on at the Meeting?**

A: Yes.

**Q: What voting majority is required?**

A: The required majority is more than 50% of the shares voted at the Meeting for the approval of Item 1 (election of directors) and Item 2 (re-appointment of the Company's independent auditors for 2007) in the Proxy Statement.

**Q: What other matters will be presented at the Meeting?**

A: The Company also will present at the Meeting the following matters relating to the fiscal year ended December 31, 2006:

- its Independent Auditors' Report, Management Report and Consolidated Financial Statements;
- the dividend paid to shareholders;

A: Just indicate on your proxy card how you want to vote, and sign and mail the enclosed return envelope as soon as possible, so that your shares will be represented at the Meeting. The signed proxy must be received by the Company at least 24 hours before the Meeting. If you sign and send in your proxy but do not indicate how you want to vote, your proxy will be counted as a vote for all the proposals.

**Q: What do I do if I want to change my vote?**

A: Just mail a later-dated, signed proxy card or other document revoking your proxy in time for it to be received by the Company at least 24 hours before the Meeting or attend the Meeting in person and vote.

**Q: If my shares are held in "street name" by my broker, a bank or other representative, will my representative vote my shares for me?**

A: If you hold your shares through a broker, bank or other representative, generally the broker or other representative may only vote the shares it holds for you in accordance with your instructions. However, if the broker or other representative does not receive your instructions in time, it may vote on certain types of matters for which it has discretionary authority.

**Q: Who can help answer my questions?**

A: For additional information about the Meeting, please contact during normal office hours, Sunday through Thursday, Yaniv Baram, the Company's Corporate Secretary at the Company's offices in Haifa, Israel, telephone +972-4-8316632.

**ELBIT SYSTEMS LTD.**
**Advanced Technology Center**
**P.O. Box 539**
**Haifa 31053, Israel**

## PROXY STATEMENT

This Proxy Statement is provided to the shareholders of ordinary shares, NIS 1.00 nominal value (the Shares ), of Elbit Systems Ltd. (the Company or Elbit Systems ), in connection with the Board of Directors solicitation of proxies for use at the Shareholders Annual General Meeting to be held on Monday, August 13, 2007 (the Meeting ), or at any adjournment of the Meeting, as specified in the accompanying Notice of Annual General Meeting of Shareholders.

It is proposed that the shareholders adopt resolutions concerning the following matters at the Meeting:

(1) election of seven directors to the Company s Board of Directors; and

(2) appointment of the Company s independent auditors for the fiscal year ending December 31, 2007.

In addition, at the Meeting the Company will present or report on the following matters relating to fiscal year 2006:

its Independent Auditors' Report, Management Report and Consolidated Financial Statements;

the dividend paid to shareholders;

the compensation paid to the Company's directors; and o the compensation arrangement with the Company's independent auditors.

Shares represented by properly signed and unrevoked proxies will be voted in the manner directed by the persons designated as proxies.

## QUORUM AND VOTING REQUIREMENTS

Only shareholders of record at the close of business on July 11, 2007 have the right to receive notice and to vote at the Meeting. Distribution of the Proxy Statement will be made following the record date.

On July 1, 2007, the Company had, 42,065,110 Shares outstanding, each giving a right of one vote for each of the matters to be presented at the Meeting. (This amount includes 23,021 Shares held by a wholly-owned subsidiary of the Company but does not include 385,900 Shares held by the Company as treasury shares.) No less than two shareholders present in person or by proxy, and holding or representing between them one-third of the outstanding Shares, will constitute a quorum at the Meeting.

If a quorum is not present within one-half hour after the time set for the Meeting, the Meeting will be adjourned and will be reconvened one week later at the same time and place unless other notice is given by the Board of Directors. If there is not a quorum within one-half hour of the time for the reconvened meeting, a quorum will be considered present as long as at least two shareholders participate in person or by proxy.

Joint holders of Shares should note that according to the Company s Articles of Association the vote, whether in person or by proxy, of the more senior of joint holders of any voted Share will be accepted over vote(s) of the other joint holders of that Share. For this purpose seniority will be determined by the order the joint holders names appear in the Company s Register of Shareholders.

A majority of the votes cast at the Meeting either in person or by proxy is required: (a) to elect, under Item 1 of this Proxy Statement, each of the individuals nominated to be a director and (b) to approve Item 2 (appointment of independent auditors) of this Proxy Statement.

## VOTING BY PROXY

A proxy form for use at the Meeting and a return envelope for the proxy form are enclosed. Shareholders may revoke any proxy form prior to its exercise by filing with the Company a written notice of revocation or a properly signed proxy form of a later date, or by voting in person at the Meeting. In order to be counted for purposes of voting at the Meeting, a properly signed proxy form must be received by the Company at least 24 hours before the Meeting.

Unless otherwise indicated on the proxy form, shares represented by a properly signed and received proxy in the enclosed form will be voted in favor of the above described matter to be presented for voting at the Meeting. Abstentions will not be treated as either a vote for or against the matter, although they will be counted to determine if a quorum is present.

Proxy forms are being mailed to shareholders on or about July 11, 2007, and will be solicited mostly by mail. However, in some cases proxies may be solicited by telephone, telegram or other personal contact. The Company will pay for the cost of the solicitation of proxies, including the cost of preparing, assembling and mailing the proxy material, and will reimburse the reasonable expenses of brokerage firms and others for forwarding material to shareholders.

## POSITION STATEMENTS

Shareholders are permitted to express their position on the proposal on the agenda of this Meeting by submitting a written statement (the Position Statement ), through the Company, to the other shareholders. Position Statements should be submitted to the Company at its registered offices, at Elbit Systems Ltd., Advanced Technology Center, Haifa, 31053 Israel, to the attention of Mr. Yaniv Baram, Corporate Secretary, no later than July 21, 2007. Reasonable costs incurred by the Company in dealing with a Position Statement will be borne by the submitting shareholder.

## BENEFICIAL OWNERSHIP OF SECURITIES BY CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table shows, as of July 1, 2007, to the best of the Company s knowledge, the number of Shares[1] owned by (i) all shareholders known by the Company to own 5% or more of the Company s Shares and (ii) all directors and officers of the Company as a group.

| | | |
|---|---|---|
| Federmann Enterprises Ltd.<br>99 Hayarkon Street<br>Tel-Aviv, Israel[2] | 19,105,448 | 45.42% |
| Heris Aktiengesellschaft<br>c/o 99 Hayarkon Street<br>Tel-Aviv, Israel | 3,836,458[3] | 9.12% |
| All officers and directors as a group (26 persons) | 176,456[4] | 0.42% |

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(1) The total number of Shares includes 23,021 Shares held by a subsidiary of Elbit Systems but excludes 385,900 Shares held by Elbit Systems as treasury shares.

(2) 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.

As of July 1, 2007, 4,655,448 Elbit Systems ordinary Shares held by FEL were pledged to Bank Leumi Le-Israel BM to guarantee loans provided to FEL in connection with FEL s purchase in 2004 of the Elbit Systems Shares held by Elron Electronics Industries Ltd. ( Elron ) as well as to guarantee a further loan provided to FEL in 2007. In addition, 1,380,000 and 970,000 Elbit Systems Shares held by FEL were pledged in favor of Koor Industries Ltd. ( Koor ) and Bank Hapoalim BM ( Bank Hapoalim ), respectively, in connection with FEL s purchase in 2006 from Koor of Elbit Systems Shares.

(3) The amount of Shares owned by Heris is included in the amount of Shares held by FEL as set forth in footnote (2) above.

(4) This amount does not include any Shares that may be deemed to be beneficially owned by Michael Federmann as described in footnote (2) above. The amount includes 8007 Shares underlying options that are currently exercisable or that will become exercisable within 60 days of July 1, 2007. A portion of the underlying options are phantom options that have been calculated based on Elbit Systems July 1, 2007 Share closing price on TASE of $42.73.

**DIRECTOR INDEPENDENCE CRITERIA AND NOMINATING COMMITTEE**

Under the Nasdaq Marketplace Rules that are applicable to the Company, a majority of the members of the Board of Directors must meet certain independence criteria. All of the members of the Audit Committee of the Board of Directors (the Audit Committee ) must meet certain independence criteria as well. In addition, in accordance with the Nasdaq Marketplace Rules, a Nominating Committee of the Board of the Directors (the Nominating Committee ), consisting in its entirety of directors meeting the board of directors independence criteria, has been created in order to nominate candidates to the Board of Directors.

**ITEM 1 ELECTION OF DIRECTORS**

At the Meeting, seven directors who are not External Directors (see list of nominees below) are to be elected. Also, if elected to another term as a director, Michael Federmann will continue to serve as Chairman of the Board of Directors. Nathan Sharony and Yaacov Lifshitz, each an External Director, will continue to serve as External Directors until the end of their terms in March 2008 and August 2009 respectively.

The Nominating Committee has recommended to the Board of Directors that all of the persons named in the list of nominees below, all of whom currently serve as directors of the Company, be nominated for re-election to the Company s Board of Directors. Three of these nominees (Moshe Arad, Avraham Asheri and Yigal Ne eman) meet the board of directors independence criteria under the applicable Nasdaq Marketplace Rules , as do the two current External Directors (Nathan Sharony and Yaacov Lifshitz).

The Board of Directors has approved the recommendation of the Nominating Committee with respect to the list of nominees. Accordingly, the persons named in the proxy card distributed with this Proxy Statement intend to vote for the election of the seven nominees named below.

Each nominee so elected as a director will hold office until the next shareholders Annual General Meeting and until his or her successor is elected and qualified, unless any director s office is vacated earlier in accordance with the provisions of the Companies Law or the Company s Articles of Association.

The Company is not aware of any reason why any of the nominees, if elected, should be unable to serve as a director. Nevertheless, if any of the nominees should be unable to serve, the proxies will be voted for the election of such other person or persons as determined by the person named in the proxy card in accordance with his or her judgment, provided such other person or persons have been recommended by the Nominating Committee for nomination to the Board of Directors.

The nominees and the current External Directors, their respective ages on July 1, 2007, and the year in which they became directors of the Company are as follows:

**Board of Directors**

| Name | Age | Director Since |
|---|---|---|
| Michael Federmann (Chairman) | 64 | 2000 |
| Moshe Arad | 72 | 2005 |
| Avraham Asheri | 69 | 2000 |
| Rina Baum | 62 | 2001 |
| David Federmann | 32 | 2007 |
| Yaacov Lifshitz (External Director) | 63 | 2003 |
| Yigal Ne'eman | 65 | 2004 |
| Dov Ninveh | 60 | 2000 |
| Nathan Sharony (External Director) | 72 | 2002 |

***Michael Federmann***. Michael Federmann has served as Chairman of the Board of Directors since the merger with Elop in 2000. He served as Chairman of the Board of Directors of Elop from 1988 until the merger. He has held managerial positions in the Federmann Group since 1969, and since 2002 he has served as Chairman and CEO of FEL. Currently, he also serves as Chairman of the Board of Directors of Dan Hotels Corp. Ltd. ("Dan Hotels"). Mr. Federmann is Deputy Chairman of the Board of Governors of the Hebrew University in Jerusalem (the Hebrew University) and a member of the Board of Governors and the Executive Council of the Weizmann Institute of Science. He serves as the President of the Israel-Germany Chamber of Industry and Commerce. Mr. Federmann holds a bachelor's degree in economics and political science from the Hebrew University.

***Moshe Arad.*** Moshe Arad served as Vice President for External Relations of the Hebrew University from 1994 to 2004. He currently serves on the Board of Directors of Discount Investment Corporation Ltd. From 1994 to 1999, he was member of the Board of Directors of Elbit Ltd. During 1992 and 1993, Mr. Arad served as Director General of the Israel Ministry of Communications. From 1990 to 1992, he was a member of the Tel-Aviv law firm of Herzog, Fox, Ne eman. Mr. Arad served as Israel s Ambassador to the United States from 1987 to 1990 and as Israel s Ambassador to Mexico from 1983 to 1987. Ambassador Arad holds a bachelor s degree in political science and international relations and a L.L.B. degree from the Hebrew University. Mr. Arad serves on the Compensation Committee of the Company s Board of Directors.

***Avraham Asheri.*** Avraham Asheri has served as an economic advisor and a director of several companies since 1998. He currently serves on the Boards of Directors of Elron Electronic Industries Ltd., Discount Mortgage Bank Ltd., Koor Industries Ltd., Mikronet Ltd. and Africa Israel Investment Ltd. Mr. Asheri was President and Chief Executive Officer of Israel Discount Bank from 1991 until 1998, and Executive Vice President and member of its management committee from 1983. Prior to that, he served for 23 years at the Israel Ministry of Industry and Trade and at the Israel Ministry of Finance, including as Director General of the Israel Ministry of Industry and Trade, Managing Director of the Israel Investment Center and Trade Commissioner of Israel to the United States. Mr. Asheri holds a bachelor s degree in economics and political science from the Hebrew University. Mr. Asheri serves as Chairman of the Compensation Committee and as a member of the Audit and Nominating Committees of the Company s Board of Directors.

***Rina Baum.*** Rina Baum is Vice President for Investments of FEL, and since 1986 has served as Director and General Manager of Unico Investment Company Ltd. She serves as a director of Dan Hotels and Etanit Building Products Ltd., as well as in other managerial positions within the Federmann Group. She also serves as a director in Harel-PIA Mutual Funds Management Company Ltd. Mrs. Baum holds an L.L.B. degree from the Hebrew University.

***David Federmann.*** David Federmann has served in various management capacities in FEL since 2000 and since 2002 as Business Development Manager of Freiberger Compound Materials GmbH in Freiberg, Germany. In 2000 he joined FEL. David Federmann is the son of Michael Federmann, Chairman of the Company s Board of Directors. David Federmann holds a bachelor s degree in mathematics and philosophy from New York University.

***Yaacov Lifshitz (External Director).*** Yaacov 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. He also currently serves on the Boards of Directors of Kali Insurance Agencies Ltd. and Carmel Investments Ltd. In addition, he is a member of the Investment Committee of Angels-Club Ltd., a company engaged in raising capital for start-up ventures. 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 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. Mr. Lifshitz is a member of the Audit and Compensation Committees of the Company s Board of Directors. Mr. Lifshitz has also been designated by the Company s Board of Directors as the Audit Committee Financial Expert under applicable U.S. and Israeli rules and regulations.

***Yigal Ne eman.*** Yigal Ne eman has served since 1994 as the Chairman and President of the Israel College. From 1989 to 1993, he served as Chairman and as a shareholder of several industrial, commercial and service companies. Mr. Ne eman served as the President and CEO of Tadiran Electronic Industry Ltd. ( Tadiran ) from 1981 to 1989. Prior to that he held a number of management positions in the control and finance departments of Tadiran. Mr. Ne eman completed his accounting studies at the Hebrew University and is a Certified Public Accountant. Mr. Ne eman serves as a member of the Audit and Nominating Committees of the Company s Board of Directors.

***Dov Ninveh.*** Dov Ninveh has served since 1994 as Chief Financial Officer and a manager in FEL. He serves as a director of Dan Hotels and Etanit Ltd. Mr. Ninveh served as a director of Elop 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 Israel Institute of Technology.

***Nathan Sharony (External Director).*** Nathan Sharony has served since 1997 as a director for several companies. He currently serves as a director for Bituach Yashir Ltd., an insurance company, Union Bank, Ormat Industries Ltd., Genoa Technologies Ltd., H-Tachof Ltd. and Israel Bonds International Inc. From 1997 to 1999, he served as Chairman of Technorov Holdings (1993) Ltd. From 1994 to 1997, he was Chief Executive Officer of Israel Bonds, a U.S. brokerage. 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 Elop and Vice President for Logistics of Tadiran Ltd. In 1982, Mr. Sharony completed 30 years of service in the Israel Defense Forces, retiring with the rank of Major General. Mr. Sharony participated in the Field Artillery Battery Officers Course in Fort Sill, Oklahoma. Mr. Sharony serves as Chairman of the Audit and Nominating Committees of the Company s Board of Directors.

**Directors Fees**

At the annual general shareholders meeting held in 2004, the Company s shareholders approved payment to directors thereafter in accordance with maximum regulatory rates payable to External Directors under Israeli law for companies similarly classified based on their shareholding equity. This amount currently includes an annual fee of $10,436 and a per meeting fee of $402. Such payments are made either directly to the director or to his or her employing company.

At the Meeting, the Board of Directors will propose that the following resolution be adopted:

RESOLVED, that Messrs. M. Federmann, Arad, Asheri, D. Federmann, Ne eman and Ninveh and Mrs. Baum are elected as directors of the Company.

**The Board of Directors recommends a vote FOR all the nominees to the Board of Directors.**

**ITEM 2 RE-APPOINTMENT OF THE COMPANY S INDEPENDENT AUDITORS FOR FISCAL YEAR 2006**

Following the recommendation by the Company s Audit Committee, it is proposed that Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global Certified Public Accountants, will be appointed as independent auditors of the Company for the fiscal year ending on December 31, 2007. A representative of the independent auditors will be present at the Meeting and will be available to respond to appropriate questions from the shareholders. Such auditors served as the Company s auditors for fiscal year 2006 and have no relationship with the Company or with any affiliate of the Company, except as auditors.

At the Meeting, the Board of Directors will propose that the following resolution be adopted:

RESOLVED, that the Company s independent auditors, Kost, Forer, Gabbay & Kasierer, a member of Ernst & Young Global, are re-appointed as independent auditors of the Company for the fiscal year ending December 31, 2007.

**The Board of Directors recommends a vote FOR approval of this resolution.**

**MATTERS TO BE REPORTED**

In addition, at the Meeting the Company will present or report on the following matters relating to fiscal year 2006:

its Independent Auditors' Report, Management Report and Consolidated Financial Statements for the fiscal year ended December 31, 2006;

the dividend paid to shareholders;

the compensation paid to the Company's directors; and

the compensation arrangement with the Company's independent auditors.

By Order of the Board of Directors,

/s/ Michael Federmann

**MICHAEL FEDERMANN**
Chairman of the Board of Directors

/s/ Joseph Ackerman

**JOSEPH ACKERMAN**
President and Chief Executive Officer

Date: July 6, 2007

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED FINANCIAL STATEMENTS
## as of December 31, 2006
## (In U.S. dollars)

**CONSOLIDATED FINANCIAL STATEMENTS**
**as of December 31, 2006**
**In U.S. dollars**

**C O N T E N T S**



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# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

U.S. dollars (In thousands)

| | | December 31, | |
|---|---|---|---|
| | Note | 2006 | 2005 |
| CURRENT ASSETS: | | | |
| Cash and cash equivalents | | $ 84,564 | $ 93,887 |
| Short-term bank deposits | | 836 | 742 |
| Available for sale marketable securities | | 2,106 | 2,282 |
| Trade receivables (net of allowance for doubtful accounts in the amount of $3,390 and $3,221 as of December 31, 2006 and 2005, respectively) | (3) | 384,487 | 346,689 |
| Other receivables and prepaid expenses | (4) | 84,601 | 67,096 |
| Inventories, net of customer advances | (5) | 371,962 | 328,428 |
| Total current assets | | 928,556 | 839,124 |
| LONG-TERM INVESTMENTS AND RECEIVABLES: | | | |
| Investments in affiliated companies, partnership and other companies | (6) | 235,723 | 201,339 |
| Compensation receivables in respect of fire damages, net | (7) | 15,530 | 15,530 |
| Long-term bank deposits and trade receivables | (8) | 6,030 | 2,457 |
| Severance pay fund | (2P) | 160,620 | 141,518 |
| | | 417,903 | 360,844 |
| PROPERTY, PLANT AND EQUIPMENT, NET | (9) | 294,628 | 284,997 |
| INTANGIBLE ASSETS, NET: | (10) | | |
| Goodwill | | 58,401 | 58,401 |
| Other intangible assets, net | | 70,594 | 78,771 |
| | | 128,995 | 137,172 |
| | | $ 1,770,082 | $ 1,622,137 |

The accompanying notes are an integral part of the consolidated financial statements

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

U.S. dollars (In thousands, except share data)

| | Note | December 31, 2006 | December 31, 2005 |
|---|---|---|---|
| CURRENT LIABILITIES: | | | |
| Short-term bank credit and loans | (11) | $ 17,802 | $ 30,296 |
| Current maturities of long-term loans | (14) | 10,199 | 7,355 |
| Trade payables | | 158,361 | 120,260 |
| Other payables and accrued expenses | (12) | 274,505 | 216,539 |
| Customers advances in excess of costs incurred on contracts in progress | (13) | 349,724 | 237,718 |
| Total current liabilities | | 810,591 | 612,168 |
| LONG-TERM LIABILITIES: | | | |
| Long-term loans | (14) | 125,266 | 224,982 |
| Advances from customers | (13) | 126,769 | 122,263 |
| Deferred income taxes | (16) | 17,640 | 25,868 |
| Accrued termination liability | (15, 2P) | 189,067 | 173,172 |
| | | 458,742 | 546,285 |
| COMMITMENTS AND CONTINGENT LIABILITIES | (17) | | |
| MINORITY INTERESTS | | 6,871 | 12,907 |
| SHAREHOLDERS' EQUITY: | (18) | | |
| Share capital: | | | |
| Ordinary shares of New Israeli Shekels (NIS) 1 par value; Authorized - 80,000,000 shares as of December 31, 2006 and 2005; Issued 42,425,595 and 41,375,545 shares as of December 31, 2006 and 2005, respectively; Outstanding 42,016,674 and 40,966,624 shares as of December 31, 2006 and 2005, respectively | | 11,876 | 11,636 |
| Additional paid-in capital | | 289,026 | 278,679 |
| Accumulated other comprehensive loss | | (16,746) | (1,340) |
| Retained earnings | | 214,043 | 166,123 |
| Treasury shares - 408,921 shares as of December 31, 2006 and 2005 | | (4,321) | (4,321) |
| | | 493,878 | 450,777 |
| | | $ 1,770,082 | $ 1,622,137 |

The accompanying notes are an integral part of the consolidated financial statements

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

U.S. dollars (In thousands, except share and per share data)

| | Note | Year ended December 31, 2006 | 2005 | 2004 |
|---|---|---|---|---|
| Revenues | (19) | $ 1,523,243 | $ 1,069,876 | $ 939,925 |
| Cost of revenues | | 1,149,768 | 786,616 | 689,626 |
| Restructuring expenses (pre-contract costs and equipment write-off) | (1G) | - | 3,488 | - |
| Gross profit | | 373,475 | 279,772 | 250,299 |
| Research and development expenses, net | (20) | 92,232 | 71,903 | 66,846 |
| Marketing and selling expenses | | 111,880 | 78,648 | 69,912 |
| General and administrative expenses | | 77,505 | 54,417 | 47,832 |
| In process research and development write-off | (1G) | - | 7,490 | - |
| | | 281,617 | 212,458 | 184,590 |
| Operating income | | 91,858 | 67,314 | 65,709 |
| Financial expenses, net | (21) | (21,456) | (11,472) | (5,852) |
| Other income (expenses), net | (6B) | 1,814 | (5,326) | 770 |
| Income before taxes on income | | 72,216 | 50,516 | 60,627 |
| Taxes on income | (16) | 20,694 | 16,335 | 15,219 |
| | | 51,522 | 34,181 | 45,408 |
| Equity in net earnings (losses) of affiliated companies and partnership (*) | (6A) | 14,743 | (1,636) | 6,645 |
| Minority interests in losses (earnings) of subsidiaries | | 5,977 | (58) | (180) |
| Net income | | $ 72,242 | $ 32,487 | $ 51,873 |
| Earnings per share | | | | |
| Basic net earnings per share | | $ 1.75 | $ 0.80 | $ 1.30 |
| Diluted net earnings per share | | $ 1.72 | $ 0.78 | $ 1.26 |
| Number of shares used in computation of basic net earnings per share | | 41,340 | 40,750 | 39,952 |
| Number of shares used in computation of diluted net earnings per share | | 41,880 | 41,623 | 41,041 |

(*) Includes in process research and development write-off of $8,500 in 2005.

The accompanying notes are an integral part of the consolidated financial statements

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# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

U.S. dollars (In thousands, except share data)

| | Number of outstanding shares | Share capital | Additional paid-in capital | Accumulated other comprehensive loss | Retained earnings | Treasury shares | Total shareholders' equity | Total comprehensive income |
|---|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2004** | 39,337,304 | $ 11,273 | $ 259,033 | $ (3,992) | $ 190,086 | $ (4,321) | $ 452,079 | |
| Exercise of options | 1,223,722 | 275 | 10,985 | | | | 11,260 | |
| Cumulative effect of first time adoption of the fair value based method for stock based compensation expenses | - | - | (152) | - | - | - | (152) | |
| Tax benefit in respect of options exercised | - | - | 1,179 | - | - | - | 1,179 | |
| Stock based compensation | - | - | 3,387 | - | - | - | 3,387 | |
| Dividends paid | - | - | - | - | (86,692) | - | (86,692) | |
| Other comprehensive income (losses) net of tax: | | | | | | | | |
| Unrealized loss on derivative instruments | - | - | - | (299) | - | - | (299) | $ (299) |
| Foreign currency translation differences | - | - | - | 450 | - | - | 450 | 450 |
| Minimum pension liability adjustment | - | - | - | (901) | - | - | (901) | (901) |
| Net income | - | - | - | - | 51,873 | - | 51,873 | 51,873 |
| Total comprehensive income | | | | | | | | $ 51,123 |
| **Balance as of December 31, 2004** | 40,561,026 | $ 11,548 | $ 274,432 | $ (4,742) | $ 155,267 | $ (4,321) | $ 432,184 | |
| Exercise of options | 405,598 | 88 | 3,423 | - | - | - | 3,511 | |
| Tax benefit in respect of options exercised | - | - | 652 | - | - | - | 652 | |
| Stock based compensation | - | - | 172 | - | - | - | 172 | |
| Dividends paid | - | - | - | - | (21,631) | - | (21,631) | |
| Other comprehensive income (losses) net of tax: | | | | | | | | |
| Unrealized gain on derivative instruments | - | - | - | 6,412 | - | - | 6,412 | $ 6,412 |
| Foreign currency translation differences | - | - | - | (924) | - | - | (924) | (924) |
| Minimum pension liability adjustment | - | - | - | (2,086) | - | - | (2,086) | (2,086) |
| Net income | - | - | - | - | 32,487 | - | 32,487 | 32,487 |
| Total comprehensive income | - | | | | | | | $ 35,889 |
| | 40,966,624 | $ 11,636 | $ 278,679 | $ (1,340) | $ 166,123 | $ (4,321) | $ 450,777 | |

| | Number of outstanding shares | Share capital | Additional paid-in capital | Accumulated other comprehensive loss | Retained earnings | Treasury shares | Total shareholders' equity | Total comprehensive income |
|---|---|---|---|---|---|---|---|---|
| **Balance as of December 31, 2005** | | | | | | | | |

The accompanying notes are an integral part of the consolidated financial statements

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (CONT.)

U.S. dollars (In thousands, except share data)

| | Number of outstanding shares | Share capital | Additional paid-in capital | Accumulated other comprehensive loss | Retained earnings | Treasury shares | Total shareholders' equity | Total comprehensive income |
|---|---|---|---|---|---|---|---|---|
| **Balance as of January 1, 2006** | 40,966,624 | $ 11,636 | $ 278,679 | $ (1,340) | $ 166,123 | $ (4,321) | $ 450,777 | |
| Exercise of options | 1,050,050 | 240 | 8,008 | - | - | - | 8,248 | |
| Tax benefit in respect of options exercised | - | - | 2,144 | - | - | - | 2,144 | |
| Stock based compensation | - | - | 195 | - | - | - | 195 | |
| Dividends paid | - | - | - | - | (24,322) | - | (24,322) | |
| Other comprehensive income (losses), net of tax: | | | | | | | | |
| Unrealized loss on derivative instruments | - | - | - | (15,642) | - | - | (15,642) | $ (15,642) |
| Foreign currency translation differences | - | - | - | 2,034 | - | - | 2,034 | 2,034 |
| Decrease in additional minimum pension liability per FAS 87 | - | - | - | 2,603 | - | - | 2,603 | 2,603 |
| Adjustment for adoption of FAS 158 for the pension plans as of December 31, 2006 | - | - | - | (4,341) | - | - | (4,341) | - |
| Adjustment for adoption of FAS 158 for the post medical plan as of December 31, 2006 | - | - | - | (252) | - | - | (252) | - |
| Unrealized gain on available for sale securities | - | - | - | 192 | - | - | 192 | 192 |
| Net income | - | - | - | - | 72,242 | - | 72,242 | 72,242 |
| Total comprehensive income | | | | | | | | $ 61,429 |
| **Balance as of December 31, 2006** | 42,016,674 | $ 11,876 | $ 289,026 | $ (16,746) | $ 214,043 | $ (4,321) | $ 493,878 | |

**Accumulated other comprehensive income (loss)(net of taxes)**

| | December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| Accumulated gains (losses) on derivative instruments | $ (10,107) | $ 5,535 | $ (877) |

| | December 31, | | |
|---|---|---|---|
| Accumulated foreign currency translation differences | 1,900 | (134) | 790 |
| Accumulated unrealized gain on available for sale securities | 192 | - | - |
| Additional minimum pension liability, FAS 87 | (4,138) | (6,741) | (4,655) |
| Adjustment for FAS 158 adoption | (4,593) | - | - |
| Accumulated other comprehensive loss | $ (16,746) | $ (1,340) | $ 4,742 |

The accompanying notes are an integral part of the consolidated financial statements.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars (In thousands)

| | Year ended December 31, | | |
|---|---|---|---|
| | 2006 | 2005 | 2004 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net income | $ 72,242 | $ 32,487 | $ 51,873 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 58,500 | 57,718 | 42,261 |
| Purchased in process R&D | - | 7,490 | - |
| Stock based compensation | 195 | 172 | 3,387 |
| Deferred income taxes | (4,659) | 6,551 | 153 |
| Accrued severance pay, net | (5,197) | (6,707) | (2,304) |
| Loss (gain) on sale of property, plant, equipment and investment | (2,351) | (731) | 143 |
| Tax benefit in respect of options exercised | - | 652 | 1,179 |
| Minority interests in earnings (losses) of subsidiaries | (5,977) | 58 | 180 |
| Equity in net losses (earnings) of affiliated companies and partnership, net of dividend received (*) | (1,696) | 13,805 | 1,505 |
| Changes in operating assets and liabilities: | | | |
| Increase in short and long-term trade receivables, and prepaid expenses | (58,793) | (43,420) | (16,871) |
| Decrease (increase) in inventories, net | (69,974) | (43,679) | 2,932 |
| Increase (decrease) in trade payables, other payables and accrued expenses | 75,869 | (37,859) | 20,522 |
| Increase (decrease) in advances received from customers | 142,844 | 202,450 | (18,535) |
| Settlement of royalties with the Office of the Chief Scientist | - | (1,371) | (3,714) |
| Other adjustments | (35) | - | (1,228) |
| Net cash provided by operating activities | 200,968 | 187,616 | 81,483 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Purchase of property, plant and equipment | (64,809) | (58,735) | (53,008) |
| Acquisition of subsidiaries and businesses (Schedule A) | - | (28,331) | (2,315) |
| Investments in affiliated companies and other companies | (31,930) | (160,861) | (18,391) |
| Proceeds from sale of property, plant and equipment | 5,705 | 2,712 | 2,560 |
| Proceeds from sale of investment | 5,000 | 3,100 | - |
| Investment in long-term bank deposits | (880) | (1,089) | (1,203) |
| Proceeds from sale of long-term bank deposits | 780 | 1,501 | 1,507 |
| Short-term deposits, net | (862) | (4) | (48) |
| Net cash used in investing activities | (86,996) | (241,707) | (70,898) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from exercise of options | 8,248 | 3,511 | 11,260 |
| Repayment of long-term bank loans | (188,723) | (85,035) | (35,826) |
| Receipt of long-term bank loans | 85,053 | 216,500 | 58,410 |
| Dividends paid | (24,322) | (21,631) | (86,692) |
| Tax benefit in respect of options exercised | 2,144 | - | - |
| Change in short-term bank credit and loans, net | (5,695) | 524 | 216 |
| Net cash provided by (used in) financing activities | (123,295) | 113,869 | (52,632) |

| | Year ended December 31, | | |
|---|---|---|---|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (9,323) | 59,778 | (42,047) |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR | 93,887 | 34,109 | 76,156 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR | $ 84,564 | $ 93,887 | $ 34,109 |
| (*) Dividend received | $ 13,047 | $ 12,169 | $ 8,150 |

The accompanying notes are an integral part of the consolidated financial statements.

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# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.)

U.S. dollars (In thousands)

| | Year ended December 31, | | |
|---|---|---|---|
| | **2006** | **2005** | **2004** |
| SUPPLEMENTAL CASH FLOW ACTIVITIES: | | | |
| Cash paid during the year for: | | | |
| Income taxes | $ 15,955 | $ 21,475 | $ 13,305 |
| Interest | $ 14,311 | $ 13,151 | $ 3,122 |
| SCHEDULE A:<br>Subsidiaries and businesses acquired (*) | | | |
| Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition was as follows: | | | |
| Working capital, net (excluding cash and cash equivalents) | $ - | $ 39,273 | $ (707) |
| Property, plant and equipment | - | (28,875) | (10) |
| Other long term assets | - | (74,363) | - |
| Goodwill and other intangible assets | - | (53,291) | (1,598) |
| In process R&D | - | (7,490) | - |
| Deferred income taxes | - | 5,404 | - |
| Long-term liabilities | - | 82,730 | - |
| Minority interest | - | 8,281 | - |
| | - | $ (28,331) | $ (2,315) |

(*) In 2004, the assets of Computer Instruments Corporation Inc. (see Note 1(D)).

In 2005, the assets of IMI (see Note 1(E)) and the shares of Elisra (see Note 1(G)).

The accompanying notes are an integral part of the consolidated financial statements.

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# 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, 45.4% owned by the Federmann Group. 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 the Elbit Systems of America ( ESA ) companies and Elbit Systems Electro-Optics Industries Elop Ltd. ( Elop ). The Company also owns 70% holdings in Elisra Electronic Systems Ltd. ( Elisra ), see Note 1(G).

B. A majority of the Group s revenues are derived from direct or indirect sales to governments or to governmental 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 governmental 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 major customers, refer to Note 19(C).

C. 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 excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $1,334 was allocated to technology ($1,000) to be amortized by the straight-line method over a period of ten years and to goodwill ($334).

The results of AD&D s operations have been included in the consolidated financial statements from the date of acquisition.

In July 2005, the Company completed the purchase of the remaining shares of AD&D in consideration for $1,025 in cash. The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $1,214 was allocated to technology ($900) to be amortized by the straight-line method over a period of eight years and to goodwill ($314).

Pro forma information in accordance with SFAS No. 141 has not been provided, since the net income of AD&D was not material in relation to total consolidated revenues and net income for the years 2004 and 2005.

D. In August 2004, the Company (through a subsidiary of ESA) acquired a business from Computer Instruments Corporation Inc. ( CIC ) of Westbury, New York in consideration for approximately $2,315 in cash. The acquired assets relate to the design and manufacture of aviation pressure transducers, air data probes and air data computers.

The acquisition was accounted for by the purchase method of accounting. The excess of the purchase price over the fair market value of the net tangible assets acquired in the amount of approximately $1,598 was allocated to technology and other intangible assets to be amortized over a weighted average period of seven years.

The results of CIC 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 CIC were not material in relation to total consolidated revenues and net income for the year 2004.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

E. In March 2005, the Company, through its wholly-owned subsidiary Cyclone Aviation Products Ltd. ( Cyclone ), acquired from Israel Military Industries Ltd. ( IMI ) the assets and customers contracts related to the Aircraft Systems Division of IMI ( the Aircraft Division ) in consideration for approximately $7 million, paid in cash (approximately $1 million out of which $718 was paid through balance sheet date) and assumed liabilities of approximately $6 million. The excess of the purchase price over the fair value of net tangible assets acquired in the amount of approximately $1,500 was allocated to customers contracts to be amortized over an estimated period of four years.

The Aircraft Division manufactures weapon payloads and external fuel tanks for fighter aircraft.

The financial results of the business acquired are included in the Company s 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 the Aircraft Division are not material in relation to the total consolidated revenues and net income for the years 2004 and 2005.

F. On December 27, 2004, the Company reached an agreement with Koor to purchase all of Koor s holdings in Tadiran Communications Ltd. ( Tadiran ), which represented approximately a 32% interest in Tadiran, at a price of $37 per share. This purchase was to be made concurrently with Koor s purchase of a portion of the Company s shares from Federmann Enterprises Ltd. ( Federmann ). Tadiran is an Israeli company, whose shares are traded on the Tel Aviv Stock Exchange. The purchase of the interest in Tadiran was made in several stages as detailed below.

Tadiran is a leading company active mainly in the defense communication area. The Company is active in the C(4)ISR area, and is using integrated communication equipment in its systems. The Company foresees synergies between its systems operations and Tadiran, by providing advanced integrated network and communication solutions to its customers. Consequently, the acquisition of Tadiran resulted in goodwill amounting to $64,200 (see below).

During 2004, the Company acquired 4.3% of Tadiran s outstanding shares on the Tel Aviv Stock Exchange in consideration for $15,900.

In the first and the second quarters of 2005, the Company acquired additional 17% of Tadiran s outstanding shares in consideration for $74,100.

As a result of the acquisition in the second quarter of 2005, the Company was able to exercise significant influence on Tadiran. In accordance with APB 18, The Equity Method of Accounting for Investments in Common Stock , the Company s interest in Tadiran, which was previously accounted for as available-for-sale securities, was accounted retroactively under the equity method of accounting ( step-by-step acquisition ).

On August 25, 2005, the Company purchased an additional 5.2% of Tadiran s outstanding shares in consideration for $23,000. Following this purchase, the Company held approximately 26.5% of Tadiran s shares.

On November 30, 2005, the Company completed the purchase of the remaining shares held by Koor in Tadiran, for approximately $59.3 million in cash. As of December 31, 2005, the Company held approximately 40% of Tadiran s shares.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

Based on a purchase price allocation analysis (  PPA  ) performed by an independent advisor, the investment amount was attributed as follows:

| | Book value in Tadiran | Excess cost | Total |
|---|---|---|---|
| Working capital | $ 14,500 | $ 100 | $ 14,600 |
| Inventory | 7,700 | 3,100 | 10,800 |
| Long-term assets and investments | 12,100 | 300 | 12,400 |
| Long-term liabilities | (14,000) | 400 | (13,600) |
| Brand name | 4,300 | 4,900 | 9,200 |
| Customer base | - | 39,400 | 39,400 |
| Technology | 3,600 | 21,100 | 24,700 |
| IPR&D | - | 9,400 | 9,400 |
| Deferred taxes | 1,100 | - | 1,100 |
| Goodwill | 21,200 | 43,000 | 64,200 |
| | $ 50,500 | $ 121,700 | $ 172,200 |

The excess costs over Tadiran  s book value in the quarters of 2005 are detailed below:

| | Until June 30, 2005 | In the third quarter of 2005 | In the fourth quarter of 2005 | Total | Expected useful lives |
|---|---|---|---|---|---|
| IPR&D | $ 5,100 | $ 1,200 | $ 3,100 | $ 9,400 | immediate write-off |
| Inventory | 1,600 | 400 | 1,100 | 3,100 | up to a quarter |
| Other tangible assets and liabilities | 400 | 100 | 300 | 800 | 5 years |
| Brand name | 2,500 | 600 | 1,800 | 4,900 | 15 years |
| Customer base and backlog | 21,200 | 5,200 | 13,000 | 39,400 | 2-12 years |
| Technology | 11,100 | 2,700 | 7,300 | 21,100 | 10 years |
| Goodwill | 22,400 | 5,500 | 15,100 | 43,000 | indefinite-subject to annual impairment test |
| Total excess of consideration over book value | $64,300 | $15,700 | $41,700 | $121,700 | |
| Percentage of interest acquired in Tadiran | 21.3% | 5.2% | 13.5% | 40% | |

On June 5, 2006, the Company acquired 4.37% of Tadiran  s outstanding shares in consideration for approximately $18.3 million. Following the acquisition, the Company holds approximately 43% of Tadiran  s shares.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

Based on a PPA performed by an independent advisor, the investment amount was attributed as follows:

| | Book value in Tadiran | Excess cost | Total | Expected useful lives of excess cost |
|---|---|---|---|---|
| Working capital | $ 2,600 | $ - | $ 2,600 | - |
| Inventory | 1,000 | 300 | 1,300 | Up to a quarter |
| Long-term assets and investments | 1,300 | 100 | 1,400 | 5 years |
| Long-term liabilities | (1,800) | - | (1,800) | - |
| Brand name | 400 | 600 | 1,000 | 15 years |
| Customer base | - | 5,300 | 5,300 | 2-12 years |
| Technology | 200 | 2,300 | 2,500 | 10 years |
| IPR&D | - | 1,000 | 1,000 | Immediate write-off |
| Goodwill | 2,500 | 2,500 | 5,000 | Indefinite - subject to annual impairment test |
| | $6,200 | $12,100 | $ 18,300 | |

G. On July 6, 2005, the Company signed an agreement with Koor to acquire all of Koor s 70% holdings in Elisra, an Israeli company, in consideration for $70 million ($68.8 million after certain adjustments) in cash. The parties also agreed on an additional contingent consideration as a result of future insurance proceeds relating to the fire at Elisra s plant in 2001 (see Note 7).

The agreement for acquiring Koor s holdings in Elisra was signed following the approval of the transaction by the Company s Audit Committee and Board of Directors, who obtained a fairness opinion from an independent appraiser regarding the consideration to be paid for the Elisra shares and following the Company s shareholders approval in August 2005.

On November 30, 2005, simultaneously with the acquisition of Koor s shares in Tadiran, the Company completed the purchase of all of the shares of Koor in Elisra for approximately $68.8 million in cash. Following the completion of the transaction, the Company owns 70% of Elisra.

The completion of the purchase of the Elisra shares was made possible following the receipt of all required approvals, including that of the Israeli Antitrust Authorities. In accordance with the Israeli antitrust approval, the Company has agreed to fulfill conditions imposed by the Antitrust Authorities related to the market environment between the Company and Israel Aircraft Industries Ltd. ( IAI ), which holds the balance of Elisra s shares. Should the Antitrust Authorities conclude, during the course of a five-year period following the acquisition, that the Company has not complied with such conditions, the Antitrust Authorities may take various measures, including steps that could result in the cessation of the joint holdings in Elisra by the Company and IAI.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

Elisra is the leading airborne electronic warfare company in Israel with advanced technology and significant market presence. Elisra has significant complementary technologies and customer installment base to those of the Group in areas including ELINT systems, EW suites, airborne warning systems and data links. As such, the Company s management believes that Elisra s business is very synergetic with several of the Company s areas of operations as the aforementioned technologies and customer installment base will enable the Group to offer more comprehensive turnkey solutions to its customers and strengthen its competitive position. Consequently, the acquisition of Elisra resulted in goodwill amounting to $24,500 (see below).

Based on a PPA performed by an independent advisor, the purchase price was attributed to the fair value of the assets acquired and liabilities assumed as follows:

| | Book value in Elisra | Excess cost | Total | Expected useful lives of excess cost |
|---|---|---|---|---|
| Current monetary liabilities net of current monetary assets | $(11,500) | $ - | $(11,500) | - |
| Pre-acquisition contingency | 15,530 | - | 15,530 | - |
| Other long-term investments and receivables | 59,270 | - | 59,270 | - |
| Long-term liabilities | (100,700) | - | (100,700) | - |
| Minority interest | (8,300) | - | (8,300) | - |
| IPR&D | - | 7,500 | 7,500 | Immediate write-off |
| Inventory | 31,200 | 1,200 | 32,400 | Up to 2 quarters |
| Property, plant and equipment | 23,100 | 5,700 | 28,800 | 20 years |
| Customers base and backlog | - | 11,800 | 11,800 | 10 years |
| Technology | - | 9,500 | 9,500 | 10 years |
| Goodwill | - | 24,500 | 24,500 | Indefinite - subject to annual impairment test |
| | $ 8,600 | $ 60,200 | $ 68,800 | |

The pre-acquisition contingency, which amount to $15,530, are related to the compensation receivables in respect of the fire damage in Elisra (see Note 7 bellow).

The results of Elisra s operations have been included in the consolidated financial statements from the date of acquisition.

The following unaudited proforma data is based on historical financial statements of the Company and Elisra and is provided for comparative purposes only. The proforma information does not purport to be indicative of the results that actually would have occurred had the purchase of the shares been consummated prior to the beginning of the reported periods.

The proforma information reflects the results of the Company s operations assuming that Elisra s results were included in the Company s consolidated results at the beginning of each of the reported periods, and under the following assumptions:

(1) Intangible assets (customer base, backlog and technology) arising from the acquisition of Elisra s shares of approximately $21,300, are amortized over a period of 10 years.

(2) Excess of cost over equity purchased allocated to real estate assets of approximately $5,700, is amortized over a period of 20 years.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

(3) The cost attributed to purchase IPR&D projects, in the amount of approximately $7,500 has been charged to operations immediately as a non-recurring item and is not included in the proforma consolidated results.

(4) Intercompany balances and transactions, if any, have been eliminated.

(5) Management fees which were paid to Elisra s shareholders and will be paid in the future to the Company were eliminated in the proforma statements.

| | For the year ended December 31, | |
|---|---|---|
| | **2005** | **2004** |
| Revenues | $ 1,264,375 | $ 1,181,110 |
| Net income as reported | $ 32,487 | $ 51,873 |
| Adjustments: | | |
| Elimination of the charge to operations for IPR&D | 7,490 | - |
| Other adjustments, net | (21,337) | 126 |
| Net income - proforma (*) | $ 18,640 | $ 51,999 |
| Basic earnings per share - proforma | $ 0.46 | $ 1.33 |
| Diluted earnings per share - proforma | $ 0.45 | $ 1.29 |

(*) The proforma net income for the year ended December 31, 2005 includes a write-off of pre contract costs and equipment, net in the amount of $2,616 in the Company and expenses related to cutback in personnel in the amount of $19,103 in Elisra (see Note 15).

Following the acquisition of Elisra s shares in the fourth quarter of 2005, the Company identified and wrote-off duplicated inventories and equipment in the amount of $3,488 which was recorded as restructuring costs in the cost of revenues.

H. In October 2005, the Company invested an amount of $2.5 million in Chip PC Ltd. ( Chip PC ), an Israeli company, in consideration for a 20% interest in Chip PC.

Chip PC develops and manufactures Post PC solutions, focused on enabling server-based- computing technologies to replace traditional PCs and deploy and control large numbers of workstations.

The excess of the amount paid for the Chip PC shares acquired over their book value is approximately $2.4 million. Based on a PPA performed by an independent advisor, this excess was allocated mainly to technology ($1.6 million) to be amortized by a straight-line method over a period of 5 8 years and to goodwill ($1.1 million). The financial results of the investee acquired are included in the Company s consolidated financial statements from the date of acquisition, as equity in net earnings (losses) of affiliated companies.

I. In October 2005, the Company established a U.K. subsidiary UAV Tactical Systems Ltd. ( U-Tacs ), in which the Company holds 51% and the rest of the shares are held by Thales U.K.. U-Tacs will be the manufacturing and support center of the Watchkeeper program an Unmanned Air Vehicle (UAV) program for the U.K. MOD. U-Tacs will establish the capabilities to design, manufacture, integrate and fly tacticalUAV systems, consisting of air vehicles, ground control stations, data links, payloads and launch and recovery subsystems (see Note 2(AA)).

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

J. On May 31, 2006, the Company s U.S. subsidiary Kollsman, Inc. ( Kollsman ) acquired Preferred B shares of Sandel Avionics, Inc. ( Sandel ), which constituted a 20% interest in Sandel on a fully diluted and as converted basis in consideration for $12.5 million (represented by a $11.5 million cash payment and a $1 million holdback to be paid within 12 months). Sandel, based in Vista, California, produces specialized integrated display systems and other products for the commercial aviation market. The Company expects that some of Kollsman s new products will be integrated with Sandel s display electronics for the general aviation market.

Kollsman has an option to buy the remaining 80% interest in Sandel for a period of 30 months after the initial investment at the equivalent price per share as the first transaction. During the option period, Kollsman has the right to representation on the Sandel board of directors, as well as several specific minority rights. In addition, Kollsman and Sandel have formed an alliance to cooperate on product development and marketing.

As the Preferred shares do not represent in substance common stock (as defined in EITF 02-14), the investment in Sandel is accounted for under the cost basis.

**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 gains 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. Resulting translation differences are recorded as a separate component of accumulated other comprehensive income in shareholders equity.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

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 Elop, ESA, Elisra 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. AVAILABLE FOR SALE MARKETABLE SECURITIES

Investments in marketable securities are classified as available for sale securities according to Statement of Financial Accounting Standard No. 115 Accounting for Certain Investments in Debt and Equity Securities , ( SFAS No. 115 ). Accordingly, these securities are stated at fair market value, with unrealized gains and losses, net of taxes, reported in accumulated other comprehensive income, a separate component of shareholders equity. Realized gains and losses on sale of investments and a decline in value which is considered to be other-than-temporary, are included in the consolidated statements of income as finance income (loss).

G. 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 include direct labor, material, subcontractors, other direct costs and an allocation of overheads, which represent recoverable costs incurred for production, allocable operating overhead cost and, where appropriate, research and development costs (refer to Note 2(T)).

Labor overhead is generally included on a basis of hourly rates and is allocated to each project according to the amount of hours expended. Material overhead is allocated to each project based on the value of direct material that is charged to the project.

Advances from customers are allocated to the applicable contract inventories and are presented as net amounts. Advances in excess of related inventories are classified as liabilities.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

H. 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 cost.

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, are 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.

A change in the Company s proportionate share of a subsidiary s or investee s equity, resulting from issuance of common or in substance common shares by the subsidiary or investee to third parties, is recorded as a gain or loss in the consolidated income statements. If the realization is not assured, such as when the issuing company is a development stage company, the gain from issuance is accounted for as an equity transaction pursuant to SEC Staff Accounting Bulletin 51 Accounting Sales of Stock by a Subsidiary .

Management evaluates investments in affiliates and other companies for evidence of other than temporary declines in value. When relevant factors indicate a decline in value that is other than temporary, the Company records a provision for the decline in value. A judgmental aspect of accounting for investments involves determining whether an other-than-temporary decline in value of the investment has been sustained. Such evaluation is dependent on the specific facts and circumstances. Accordingly, management evaluates financial information (e.g. budgets, business plans, financial statements, etc.) in determining whether an other-than-temporary decline in value exists. Factors indicative of an other-than-temporary decline include recurring operating losses, credit defaults and subsequent rounds of financings at an amount below the cost basis of the investment. This list is not all inclusive and management weighs all quantitative and qualitative factors in determining if an other-than-temporary decline in value of an investment has occurred. The results of 2005 include an impairment loss related to the investment in ISI (see Note 6(B)2)).

I. LONG-TERM RECEIVABLES

Long-term trade and other receivables, from extended payment agreements, are recorded at their estimated present values (determined based on the original market rates of interest).

J. LONG-TERM BANK DEPOSITS

Long-term bank deposits are deposits with maturities of more than one year. These deposits are presented at cost and with accumulated interest.

K. 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.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

Depreciation is calculated by the straight-line method over the estimated useful life of the assets at the following annual rates:

| | % |
|---|---|
| Buildings | 2-6.6 |
| Instruments, machinery and equipment | 6-33 |
| Office furniture and other | 6-33 |
| Motor vehicles | 12-33 (mainly 15%) |

Land rights and leasehold improvements generally over the term of the lease.

L. INVESTMENT GRANTS

As a governmental incentive for industrial companies in Israel, the Investment Center , which is a branch of the Israel Ministry of Industry and Trade, permits industrial companies to submit a request to qualify as an Approved Enterprise . An Approved Enterprise is entitled to certain benefits in respect of capital investments. The benefits may be in the form of reduced tax rates and of capital grants received as a percentage of the investments of the Approved Enterprise. The amount of a capital grant is determined as a percentage of the Approved Enterprise investment in property, plant and equipment. As a condition to the granting of these benefits, the Approved Enterprise is obligated to perform the applicable industrial plan as detailed in the request to the Investment Center (see Note 16(A)(3) and 17(K)). These capital grants are non-royalty bearing and are not conditioned on the results of operations. As the capital grants are a direct participation in the cost of the acquisition of property, plant and equipment they are offset against the cost of property, plant and equipment.

M. INTANGIBLE ASSETS

Intangible assets are stated at cost net of accumulated amortization. Intangible assets are amortized over their useful life using the straight-line method.

N. IMPAIRMENT OF LONG-LIVED ASSETS

The Group s long-lived assets and 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.

O. GOODWILL

Goodwill represents the excess of the cost of acquired businesses over the net fair values of the assets acquired and liabilities assumed. Under SFAS No. 142, goodwill is no longer amortized, but is instead tested for impairment at least annually (or more frequently if impairments indicators arise).

SFAS 142 prescribes a two phase process for impairment testing of goodwill. The first phase screens for impairment, while the second phase (if necessary) measures impairment.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

In the first phase of impairment testing, 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 of the reporting unit exceeds its fair value, the second phase is then performed. The second phase of the goodwill impairment test compares the implied fair value of the reporting unit s goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit s goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess.

Fair value of a reporting unit is determined using the discounted future cash flows method. 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.

For each of the three years in the perios ended December 31, 2006, no impairment losses have been identified.

P. 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 benefit is calculated based on the employee s latest salary and the period of his/her employment.

The Group s companies in Israel record a liability for the amount that would have to be paid to the employees as severance payment in the event of the companies shut down.

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 values of the deposited funds are based on the cash surrendered value of these funds and include profits.

Severance pay expenses for the years ended December 31, 2006, 2005 and 2004 amounted to approximately $19,161, $17,500 and $15,574, respectively.

Q. REVENUE RECOGNITION

The Group generates revenues mainly from long-term contracts involving the design, development, manufacture and integration of defense systems and products. In addition, to a minor extent, the Company is 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 ) according to which revenues are recognized on the percentage-of-completion basis.

Sales under long-term fixed-price contracts which provide for a substantial level of development efforts in relation to total contract efforts are recorded using the cost-to-cost method of accounting as the basis to measure progress toward completing the contract and recognizing revenues. According to this method, sales and profits are recorded based on the ratio of costs incurred to estimated total costs at completion. In certain circumstances, when measuring progress toward completion, the Company considers other factors, such as achievement of performance milestones.

Sales and anticipated profit under long-term fixed-price production type contracts are recorded on a percentage-of-completion basis, using the units-of-delivery as the basis to measure progress toward completing the contract and recognizing revenues. In certain circumstances, which involve long-term fixed-price

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

production type contracts for non-homogenous or small quantity of units, revenue is recognized based on the achievement of performance milestones, which provide a more reliable and objective measure to the extent of progress toward completion.

Sales and anticipated profit under long-term fixed-price contracts that involve both development and production are recorded using the cost-to-cost method and units-of-delivery method as applicable to the phase of the contract, as the basis to measure progress toward completion. In addition, when measuring progress toward completion under the development portion of the contract, the Company considers other factors, such as achievement of performance milestones.

The percentage-of-completion method of accounting requires management to estimate the cost and gross profit margin for each individual contract. Estimated gross profit or loss from long-term contracts may change due to changes in estimates resulting from differences between actual performance and original estimated 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. Anticipated losses on contracts are charged to earnings when determined to be probable.

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.

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.

In cases where the contract involves the delivery of products and performance of services, the Group follows the guidelines specified in EITF 00-21, Revenue Arrangements with Multiple Deliverables in order to allocate the contract fees between the products accounted for under SOP 81-1 and the services.

In certain circumstances, sales under short-term fixed-price production type contracts are accounted for in accordance with SAB No. 104, Revenue Recognition in Financial Statements ( SAB 104 ), and recognized when the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the seller s price to the buyer is fixed or determinable, no further obligation exists and collectability is reasonably assured.

As for research and development costs accounted for as contract costs refer to Note 2(T).

R. PRE-CONTRACT COSTS

Pre-contract costs are deferred and included in inventory, only when such costs can be directly associated with a specific anticipated contract and if their recoverability from the specific contract is probable according to the guidelines of SOP 81-1.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

S. 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 products, 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, which is included in the Company s balance sheet, during the years, are as follows:

| | 2006 | 2005 |
|---|---|---|
| Balance, at January 1 | $ 31,797 | $ 34,230 |
| Warranties issued during the year | 27,733 | 19,223 |
| Warranties forfeited or exercised during the year | (15,113) | (21,656) |
| Balance, at December 31 | $ 44,417 | $ 31,797 |

T. RESEARCH AND DEVELOPMENT COST

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 participates 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 part of the 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. The grants are not to be repaid, but instead the Group companies will be sometimes obliged to pay royalties as a percentage of future sales if and when sales are generated from the funded projects. These grants are recognized as a deduction from research and development costs at the time the applicable company is entitled to such grants on the basis of the research and development costs incurred, since the payment of royalties is not probable when the grants are received.

U. 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 asset 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 amounts that are more likely than not to be realized.

V. CONCENTRATION OF CREDIT RISKS

Financial instruments that potentially subject the Group to concentrations of credit risk consist principally of cash and cash equivalents, short and long-term deposits and trade receivables.

# ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONT.)

U.S. dollars (In thousands, except per share data)

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 United States. 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 stable 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.

W. DERIVATIVE FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( SFAS No. 133 ), requires companies to recognize all 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 operation.

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 effective portion of the gain and loss on thederivative 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 value. The remaining gain or loss o