MANAGEMENT REPORT FOR 2005

The following discussion should be read in conjunction with our consolidated financial statements for the year ended December 31, 2005 and the notes thereto, which are included in this Annual Report. This report contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements may be identified by the words "anticipate", "believe", "estimate", "expect", "plan" and similar expressions. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those discussed in our filings with the Securities and Exchange Commission from time to time.

OVERVIEW

We are a high technology operational holding company that operates through subsidiaries and affiliated companies, referred to as our group companies. Founded in 1962, we have been a major force in the development of the Israeli high technology industry by building Israeli and Israel-related companies with technologies in the fields of medical devices, advanced defense electronics, communications, semiconductors, software products and services and advanced materials.

Some of our group companies grew out of our subsidiary, RDC-Rafael Development Corporation Ltd. ("RDC"), established with Rafael, the largest research and development organization of Israel's Ministry of Defense. RDC was established pursuant to an agreement entered into in July 1993 for the purposes of exploiting Rafael's technology in non-military markets. RDC has first rights to commercially exploit technologies of Rafael in non-military markets.

Our group companies include both publicly traded and privately held companies.

Our activities range from operational control over the business to involvement in the management of our group companies in which we maintain controlling or significant holdings, and, in a limited number of cases, non-significant holdings. We participate in the management of most of our group companies by means of active membership on their boards of directors and board committees. As a result, we are involved in matters of policy, strategic planning, marketing, selecting and manning senior management positions, approving investments and budgets, financing and the overall ongoing monitoring of our group companies' performance. In addition to our representation on the boards of directors of our group companies, we provide hands-on assistance to the group companies' management in support of their growth. We view our hands-on involvement in the operations of our group companies as a key element of our business. Our group companies therefore benefit from the experience of our management team in various areas in which they need support and leadership, including, but not limited to, strategic planning, research and development guidance, identifying joint venture opportunities, introductions to potential customers and investors, risk management, market analysis, business plan preparation, budgetary control, and legal support.

Technology industries are characterized by the high degree of risk inherent in their products, their continuous technological innovation and their penetration into world markets, which requires investment of considerable resources and continuous development efforts. The future success of our group companies is dependent upon their technological quality, prices and nature of their products in comparison to their competitors and their ability to introduce new products to the markets at the right time, while offering cost effective solutions suitable to their customers' needs as well as their ability to raise financing and the condition of the capital markets.

We expect to continue to build and realize value for our shareholders through the sale to third parties of a portion or all of our holdings in, or through the issuance of shares by, our group companies, while simultaneously pursuing the acquisition

of, or investment in, new and existing companies at different stages of development including early stage and more mature companies. We believe that this strategy provides the ability to increase shareholder value as well as to create capital to support the growth of our group companies and to invest in new opportunities. The nature of our business, therefore, will result in some volatility in our results of operations, depending on the transactions that occur within a particular period.

Our net income (or loss) in any given period is due, for the most part, to the results of operations of those of our group companies which are accounted by us under the consolidation or equity method of accounting and dispositions and changes in our holdings of group companies. As most of our group companies are technology companies which have not yet generated significant revenues and which invest considerable resources in research and development and in marketing activities, we have experienced, and expect to continue to experience, losses in respect of these companies. However, as a result of recent accounting pronouncements described below under "CRITICAL ACCOUNTING POLICIES", some of our group companies and new companies in which we may invest may be accounted for at cost, thereby not affecting our results of operation.

Our capital resources in any given period are primarily affected by the extent of our investment in existing and new companies and the realization of certain holdings as well as the impact of any dividends or distributions to our shareholders. The results of operations of our group companies, and consequently, our results of operations and capital resources, are affected by general economic conditions as well as by factors specifically related to the technology markets, which also affect the ability of our group companies to raise financing and our ability to dispose of holdings and realize gains from our holdings.

TREND INFORMATION

Technology industries are affected by economic trends and the condition of the capital markets. Since the second half of 2003, there has been a recovery in the technology sectors and capital markets from the downturn which commenced in 2001. This trend was reflected in the improvement in the results of operations of most of our group companies as well as the raising of funds from new strategic and other investors in private placements completed by some of our group companies. In addition, we recorded significant gains from realizing certain of our holdings, mainly in 2004 as a result of the sale of our holdings in Elbit Systems Ltd. (Nasdaq: ESLT) ("Elbit Systems"), and in the second quarter of 2005 from the sale of most of our shares in Partner Communications Company Ltd. (Nasdaq: PTNR) ("Partner") and the sale of all of our shares in Oren Semiconductor, Inc. ("Oren") (see below under "MAJOR TRANSACTIONS AND NEW INVESTMENTS"). Should the improvement in the technology sectors and capital markets continue, we anticipate that it will have a positive effect on our group companies and their ability to raise additional capital. In addition, during the last two years we invested approximately $48.3 million in new companies (see below under "MAJOR TRANSACTIONS AND NEW INVESTMENTS" for more information regarding new investments in 2005) and an additional $64.8 million in existing group companies (mainly in Given Imaging).

MAJOR TRANSACTIONS AND NEW INVESTMENTS

Sale of a majority of our holdings in Partner Communications Company Ltd ("Partner"). On April 20, 2005, we completed the sale of 12,765,190 shares of Partner held by us, to Partner, for approximately $94.0 million, as part of the sale together with the other Israeli founding shareholders of Partner, of an aggregate of 33,317,933 Partner shares to Partner for aggregate consideration of approximately $245 million. As a result, we recorded in 2005, a gain, net of tax, of approximately $45.4 million. Following the sale, we continue to hold 3,091,361 shares of Partner, representing approximately 2% of Partner's outstanding shares, almost all of which are subject to transfer restrictions under Partner's Israeli communications license but are no longer pledged to secure debt of Partner.

On March 8, 2006 we announced the signing of a definitive agreement to acquire approximately 823,000 shares of Partner from one of the other Israeli founding shareholders of Partner for approximately $5.3 million, reflecting an approximately 15% discount from the market price, subject to adjustments in accordance with the terms of the agreement. Upon completion of the acquisition, we will hold approximately 2.6% of Partner. Almost all of these shares are subject to transfer restrictions under Partner's license. The completion of the acquisition is subject to the satisfaction of certain closing conditions including regulatory approval. There is no assurance that the acquisition will be completed.

Investment in NuLens Ltd. ("NuLens"). On April 21, 2005, we invested approximately $1.7 million in NuLens, an Israeli medical device company operating in the field of intra-ocular lenses, mainly for cataract and presbyopia procedures. The investment is the first of two installments, of which the second of approximately $1.2 million was invested on March 9, 2006, simultaneously with the closing of a new investment round. The total investment of $2.9 million was part of an aggregate investment of approximately $3.4 million.

In addition, we invested an additional amount of approximately $1.5 million as part of an aggregate new investment of approximately $6 million, led by Warburg Pincus, a leading global private equity fund. Following the above investments, Elron holds 25% of NuLens, on a fully diluted and on an as converted basis.

Investment in Teledata Networks Ltd. ("Teledata"). On May 8, 2005, we completed a new investment of $16 million in Teledata. The investment was part of an aggregate round of financing of $19 million in which FBR Infinity II Ventures ("Infinity"), a venture capital fund related to us, invested $3 million. Following the investment, we hold approximately 21% of Teledata and Infinity holds approximately 4% of Teledata, each on a fully diluted basis. We and Infinity entered into a voting agreement with respect to our holdings in Teledata. Teledata provides innovative access products and solutions for both traditional and next generation networks to telecom operators and service providers.

NetVision Initial Public Offering. NetVision provides Internet services and solutions in Israel and, commencing in the fourth quarter of 2004, international telephony services through Voice over IP technology (VoIP). On May 19, 2005, NetVision Ltd. ("NetVision") completed its initial public offering on the Tel Aviv Stock Exchange ("TASE"), in Israel of shares and convertible securities in consideration for aggregate immediate net proceeds of approximately NIS135 million (approximately $31 million). In addition, future proceeds from the exercise of options sold in the offering may amount up to approximately NIS28.8 million (approximately $6.6 million). Discount Investment Corporation Ltd. ("DIC"), which currently holds approximately 47.5% of our shares, is the other major shareholder of NetVision. We and DIC each converted approximately $3.1 million of loans into equity of NetVision immediately prior to the offering and $2.2 million in loans was repaid to each of us from the proceeds of the offering. As a result of the initial public offering, our holding in NetVision decreased from 45.7% to approximately 39% (27.4% on a fully diluted basis taking into account the possible exercise of the convertible securities) resulting in a gain for us of approximately $3.0 million.

Sale of holdings in Oren. On June 10, 2005, Zoran Corporation, or Zoran (Nasdaq: ZRAN), completed the acquisition of Oren in which we held a 41% interest. From the proceeds of the acquisition, we received cash of approximately $12.5 million (of which approximately $2.0 million is held in escrow under the terms of the agreement) and 613,410 Zoran shares with a market value of approximately $7.7 million based on Zoran's share price on the completion date of the acquisition. As a result of the transaction, we recorded a gain in 2005, net of tax, of approximately $17.2 million. The common shares of Zoran were sold in July 2005 for $8.8 million, resulting in a gain, net of tax, of $0.7 million.

Investment in BrainsGate Ltd. ("BrainsGate"). On August 8, 2005, we completed an investment of approximately $6.9 million in BrainsGate in consideration for approximately 20% of BrainsGate on a fully diluted basis, as part of an aggregate investment of approximately $17.0 million. Infinity, with whom we have a voting agreement, holds approximately 5% of BrainsGate on a fully diluted basis. BrainsGate is an Israeli company that develops innovative technologies for neuro–stimulation treatments of brain diseases.

Dividend distribution. On September 5, 2005, we declared a cash dividend of $3.00 per share, totaling approximately $88.5 million. The dividend was paid on September 27, 2005, to shareholders of record on September 15, 2005.

Investment in Enure Networks Ltd. ("Enure" formerly known as Gaia Broadband Services Management Ltd.). On October 2, 2005, we completed an investment of approximately $4.0 million in Enure in consideration for approximately 44% of Enure on a fully diluted basis. Enure is an Israeli software company engaged in developing solutions in the field of broadband services management and home networks.

Sale of holdings in Elron Telesoft Ltd. and Elron Telesoft Export Ltd. (the " ET group"). On December 29, 2005, we completed the sale of all of our shares of the ET group to ECtel Ltd. (Nasdaq: ECRX) for $2.5 million, of which $0.4 million shall be paid if certain milestones will be achieved during 2006. The transaction resulted in no material gain. The business sold by the ET group met the criteria for reporting discontinued operations according to SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" and therefore the 2005 results of operations of the business sold and the gain on the sale have been classified as discontinued operations in the statement of operations and prior periods results have been reclassified accordingly. In addition, the comparative data of the assets and liabilities have been reclassified as assets and liabilities attributed to discontinued operations in the balance sheet.

Investment in Safend Ltd. ("Safend"). On January 2, 2006, we completed an investment of approximately $3.7 million in Safend in consideration for approximately 24% of Safend on a fully diluted basis. Safend is an Israeli company which develops comprehensive desktops and laptops endpoint security solutions.

CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

Following the sale of our shares in Elbit Systems in 2004, we announced that, as a result of the transaction, we may be characterized as a passive foreign investment company ("PFIC") for U.S. federal income tax purposes for 2004. This would result in adverse tax consequences for our U.S. shareholders but not for Elron. Following a review of our position and consulting with our advisors on this matter in 2004, and based on certain assumptions and facts known at that time (which we believe have not changed), we believe there is substantial authority for the position that we can rely on the

"change of business" exception to PFIC status provided under Section 1298(b)(3) of the U.S. Internal Revenue Code of 1986, as amended. Substantial authority is generally sufficient to support a return reporting position. Pursuant to this exception, in order to avoid PFIC status in 2004, among other requirements, we cannot be a PFIC in 2005 or 2006 (which cannot be determined at this time with respect to 2006) or in any year prior to 2004 (which we believe was not the case).
With respect to 2005, we previously advised our shareholders that as a result of the sale of Partner shares in the second quarter of 2005, it would be reasonably possible that we would be treated as a PFIC for 2005, and, as a result, in 2004. However, currently, based on a preliminary analysis made by us, we believe that we would not be treated as a PFIC for 2005, mainly as a result of the distribution of the above mentioned cash dividend. We will advise our shareholders with respect to our 2005 status as soon we have concluded our determination.
With respect to 2006, the ultimate determination of our PFIC status will depend on the composition of our gross income and assets for the entire year, and the values of those assets, which are difficult to predict at this time and the appropriate value of our ownership interest in our group companies.
Therefore, it is unclear whether the "change of business" exception would ultimately be satisfied for 2004. We cannot assure shareholders that the IRS will not challenge our reliance on the "change of business" exception or our assumptions used in determining our percentage of passive assets and income. If there are such challenges, we could be classified as a PFIC for 2004, even if we are not a PFIC in 2005 and 2006. Furthermore, there can be no assurance that we will not become a PFIC in the future.
Elron does not provide U.S. tax advice and shareholders are urged to consult their own tax advisors.

CRITICAL ACCOUNTING POLICIES

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States ("US GAAP"). Our significant accounting policies are more fully described in Note 2 to our Consolidated Financial Statements. Certain accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Principles of accounting for holdings in group companies
- Business combinations and purchase price allocation
- Impairment of goodwill and other intangible assets
- Other-than-temporary decline in value of investments in group companies
- Accounting for income taxes

Principles of Accounting for Holdings in Group Companies

The various holdings that we have in our group companies are accounted for under several methods, based among others, on our level of ownership and the type and form of our holdings in our group companies, as described below.

Consolidation. Companies over which we have control are accounted for under the consolidation method of accounting. Control is usually assumed when we own and/or our subsidiary owns more than 50% of the outstanding voting securities of a company. However, whether or not we control a group company also depends on an evaluation of several factors, including, among others, our representation on the board of directors, the level of financing provided by us to the group company and any minority rights and other factors which require management to make judgment and involve the use of significant estimates and assumptions.

Under the consolidation method, a controlled company's assets and liabilities are included within our consolidated balance sheet and its income and expense items are included within our consolidated statements of operations. The share of other shareholders in the net assets and in the net income or losses of a consolidated company is reflected in minority interest in our consolidated balance sheet and in our consolidated statements of operations, respectively. The minority interest amount adjusts our consolidated net income (loss) to reflect only our share in the earnings or losses of any consolidated company.

Notwithstanding the above, in January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46, "Consolidation of Variable Interest Entities – An Interpretation of Accounting Research Bulletin No. 51" ("FIN 46"), relating to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003) (FIN 46R), which replaced FIN 46. FIN 46R defines the provisions under which a Variable Interest Entity ("VIE") should be consolidated. In general, a VIE is a corporation, partnership, limited-liability corporation, trust, or any other legal structure used to conduct activities or hold assets that either (1) has an insufficient amount of equity to carry out its principal activities without additional subordinated financial support, (2) has a group of equity owners that is unable to make significant decisions about its activities, or (3) has a group of equity owners that does not have the obligation to absorb losses or the right to receive returns generated by its operations. FIN 46R provides several exceptions to its scope, such as that an entity that is deemed to be a business need not be evaluated to determine if it is a VIE unless one of the conditions specified in FIN 46R exists FIN 46 requires a VIE to be consolidated by the party with an ownership, contractual or other financial interest in the VIE (a variable interest holder) that will absorb a majority of the risk of loss from the VIE's activities, is entitled to receive a majority of the VIE's residual returns (if no other variable interests absorb a majority of the VIE's losses), or both. A variable interest holder that consolidates the VIE is called the primary beneficiary.

As an operational holding company, we have made investments in and granted loans to companies that are engaged in various fields of high technology. Some of these companies are in their early stages of development and will require substantial external investments until they can finance their activities without additional support from other parties and may be considered VIEs. These companies are currently primarily funded with financing from venture capital funds, other holding companies and private investors.

Assessment of whether a group company is within the scope of FIN 46R, whether a group company is a VIE and the determination of the primary beneficiary is judgmental in nature and involves the use of significant estimates and assumptions regarding the fair value of certain entities and their variable interests. The estimates and assumptions include, among others, forecasted cash flows, their respective probabilities and the economic value of certain preference rights. As of December 31, 2005 Wavion Inc. ("Wavion") in which we hold approximately 37.8% is considered a VIE, but Elron is not its primary beneficiary. As of December 31, 2005, our maximum exposure to loss as a result of our involvement in Wavion does not exceed the carrying value of our investment in Wavion in the amount of approximately $0.8 million.

Equity Method. Group companies which we do not control, but in which we exercise significant influence over the operating and financial policies and in which we hold common stock or in-substance common stock as defined EITF 02-14 "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock" ("EITF 02-14") (which is further described below), are accounted for under the equity method of accounting. Significant influence is usually assumed when we hold 20% or more of a group company's voting securities, however, whether or not we exercise significant influence with respect to a group company also depends on an evaluation of several additional factors, including, among others, our representation on the board of directors, agreements with other shareholders, our participation in policy making processes, the existence of material intercompany transactions and technological dependency, the extent of ownership by an investor in relation to the concentration of other shareholdings, and other factors which may require management to make certain judgmental decisions regarding significant influence.
EITF 02-14, which became effective at the beginning of the fourth quarter of 2004, defines in-substance common stock as an investment with similar risk and reward characteristics to common stock. In certain holdings we invested, among others, in preferred shares which include rights, among others, such as cumulative and participating dividends, dividend preferences and liquidation preferences. Based on EITF 02-14, new companies in which we invested in the fourth quarter of 2004 and in 2005, namely Jordan Valley, Impliant, Teledata, NuLens and BrainsGate, are being accounted for at cost notwithstanding our significant influence in such companies, as the investment in these companies is not considered to be in-substance-common stock. Any assessment of whether we hold in substance common stock in a group company is judgmental in nature and involves the use of significant estimates and assumptions such as assessing the fair value of the subordinated equity of the group company.

We also account for our interests in private equity funds under the equity method of accounting, based on our holding percentage.

Under the equity method of accounting, a group company's assets and liabilities are not included within our consolidated balance sheet and their results of operations are not reflected within our consolidated statements of operations. However, our share in the net income or losses of the group company is reflected as an equity income (loss) in our consolidated statements of operations. The share of income or losses is generally based upon our ownership level of the outstanding share capital of the group company. Notwithstanding the above, in circumstances where the equity method is being applied and our ownership in an investee is in the form of a preferred security or other senior security which is considered to be in substance common stock, we recognize equity method losses based on our ownership level in the particular investee security or loan held by us to which the equity method losses are being applied.

Other Methods. Our holdings in companies that we do not account for under either the consolidation or the equity method of accounting are accounted for under three different methods:

- Non-marketable securities are presented at cost. Under this method, our share in the income or losses of these entities is not included in our consolidated statements of operations.
- Marketable securities, which are classified as trading securities, are presented at fair market value and the changes in the market value are reflected in our results of operations during each reporting period.
- Marketable securities which are classified as available-for-sale are presented at fair market value and the effect of any unrealized change in market value is reflected in other comprehensive income (loss). When realized, realized gain or loss is included in our results of operations.

Business Combinations and Purchase Price Allocation

Business combinations are accounted for using the purchase method of accounting, under which the total purchase price is allocated to the acquired company's assets and liabilities, based on their estimated fair values, and the remainder, if any, is attributed to goodwill.

The aggregate purchase price of any investment accounted for under either the consolidation or the equity method of accounting is being allocated to identifiable net assets, intangible assets other than goodwill, in-process research and development ("IPR&D") activities, and to goodwill. The amount allocated to IPR&D is being charged immediately to our results of operations in accordance with FASB Interpretation No. 4, "Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method" ("FIN 4"). The amounts allocated to intangible assets other than goodwill are amortized on a straight-line basis over their weighted average expected useful life. In 2005 and 2004, IPR&D charges amounted to $1.1 million and $2.3 million (which are part of our share in the net income or loss of affiliated companies). IPR&D in 2004 resulted mainly from the purchase of Given Imaging shares for approximately $43.9 million.

Estimating the fair value of certain assets acquired and liabilities assumed is judgmental in nature and often involves the use of significant estimates and assumptions, mainly with respect to intangible assets. While there are a number of different methods for estimating the value of intangibles acquired, the primary method being used is the discounted cash flow approach. Some of the more significant estimates and assumptions inherent in the discounted cash flow approach include projected future cash flows, including their timing, a discount rate reflecting the risk inherent in the future cash flows and a terminal growth rate. Another area which required judgment which can impact our results of operations was estimating the expected useful lives of the intangible assets. To the extent intangible assets are ascribed with longer useful lives, there may be less amortization expenses recorded in any given period. As we and our group companies operate in industries which are rapidly evolving and extremely competitive, the value of the intangible assets, including goodwill, their respective useful lives and the investments in companies is exposed to future adverse changes which can result in a charge to our results of operations (See also "Other-Than-Temporary Decline in Investments in Group Companies" under this section).

Impairment of Goodwill and Other Intangible Assets

We conduct a goodwill impairment review at least annually on goodwill and on an interim basis whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that we consider important which could trigger an impairment review include significant underperformance relative to historical or expected future operating results and significant negative industry or economic trends. We test for impairment at a level referred to as a reporting unit. Determining fair value involves the use of significant estimates and assumptions. These estimates and assumptions could have an impact on whether or not an impairment charge is recognized. To determine fair value, we may use a number of valuation methods including quoted market prices, discounted cash flows and revenue multipliers. As mentioned above, these approaches use estimates and assumptions including projected future cash flows, discount rate and terminal growth rate. Using different assumptions could result in different results. In 2005 and 2004, a goodwill impairment charge in the amount of $1.3 million and $2.0 million, respectively, was recorded with respect to the operation of the ET group in light of its results of operation (following the sale of this business, these charges are presented as part of the loss from discontinued operations in the statements of operations). As we operate in industries which are rapidly evolving and

extremely competitive, it is possible that our estimates could change in the near term and there can be no assurance that future goodwill impairment review will not result in an additional charge to our results of operations. At December 31, 2005, consolidated goodwill amounted to approximately $2.7 million.

Other intangible assets with definite useful lives are reviewed for impairment 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 considered 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. In the evaluation of fair value, we use significant estimates and assumptions such as projected future cash flows which are subject to high degree of judgment. In 2004 we recorded impairment charges of other intangible assets of $2.9 million with respect to the ET group in light of its results of operation (following the sale of this business, this charge is presented as part of the loss from discontinued operations in the statements of operations). In addition in 2004 we recorded impairment charges of other intangible assets of $4.2 million with respect to MediaGate due to our revised estimate about future proceeds from the sale of its technology. As we operate in industries which are rapidly evolving and extremely competitive, changes in the assumptions and estimates may affect the carrying value of the intangible assets, and could result in an additional impairment charge to our results of operations. At December 31, 2005, consolidated intangible assets, other than goodwill, amounted to approximately $2.8 million.

Other-Than-Temporary Decline in Value of Investments in Group Companies

At the end of each reported period we evaluate whether an other-than-temporary decline in value of an investment in a group company has been sustained. This evaluation is judgmental in nature. If it has been determined that an investment has sustained an other-than-temporary decline in its fair value relative to its carrying value, the investment is written down to its fair value by a charge to our results of operations.

An evaluation of fair value is dependent upon specific facts and circumstances. Factors that are considered by us in this determination include financial information (including, among others, budgets, business plans and financial statements) and the value at which independent third parties have invested or have committed to invest and independent appraisals, if available. Factors indicative of an other-than-temporary decline include recurring operating losses, credit defaults, specific conditions affecting the investment, such as in the industry or in geographic area, and subsequent rounds of financing at an amount below the cost basis of the investment. This list is not all inclusive and we weigh all quantitative and qualitative factors in determining if an other-than-temporary decline in value of an investment has occurred. As we operate in industries which are rapidly evolving and extremely competitive, it is possible that our estimates could change in the near term and there can be no assurance that an additional write-down or write-off of the carrying value will not be required in the future. In 2005 and 2004 we recorded write-downs in the amounts of $6.0 million and $1.5 million, respectively, with respect to certain group companies (in 2005 mainly with respect to Oncura and Avantry Ltd., and in 2004 mainly with respect to Textology Inc,. 3DV Systems Ltd. ("3DV") and Ingeneo Ltd.).

Accounting for Income Taxes

At the end of each reported period, we are required to estimate our income taxes. This process requires us to estimate our

actual current tax liabilities and make an assessment of temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be realized through future taxable income and, to the extent we believe that realization is not likely, we must establish a valuation allowance. Management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. Our judgment as to the probability to realize our net deferred tax assets is largely based upon interpretations of certain tax laws and estimates and assumptions mainly with respect to our ability to realize investments in our group companies. Our ability to realize investments is mainly dependent upon factors such as the condition of the securities markets and other general economic conditions. As the securities markets for our group companies are highly volatile, changes in our assumptions and estimates may require us to increase the valuation allowance and therefore we may be required to include an expense within the tax provision in our statement of operations.

As of December 31, 2005, deferred tax assets with respect to the corporate carryforward losses that are more likely than not to be realized in future years amounted to approximately $6.5 million ($10.6 million as of December 31, 2004). In 2005, we reduced our previous valuation allowance by $19.6 million, which included $14.4 million as a result of Elbit's receipt final tax assessment, of which $3.9 million was recorded as a reduction of goodwill since the deferred tax assets related to carryforward losses of Elbit incurred in periods prior to our acquisition of Elbit) and $5.0 million as a result of the sale of the ET group. In 2004, we reduced our previous valuation allowance by $28.7 million in respect of losses incurred in prior periods mainly due to the sale of our shares in Elbit Systems and due to final tax assessments for previous years. Deferred tax liabilities amounted as of December 31, 2005, to $9.5 million, mainly with respect to our investment in Partner which is accounted for as available-for-sale securities.

As of December 31, 2005 Elron has carryforward losses of approximately $69.0 million.

BASIS OF PRESENTATION

Consolidation. Our consolidated financial statements include the accounts of Elron and all of our direct or indirect (through Elbit and DEP) controlled subsidiaries. The following are our main subsidiaries:

Year ended December 31,					
2005			2004		
Elron	SELA	3DV	Elron	MediaGate	ESW [4]
TeleSoft[1]	MediaGate	Starling	TeleSoft	3DV	SELA[5]
RDC	Medingo[2]	Enure[3]	RDC	Starling	
Galil Medical			Galil Medical		

[1] Sold on December 29, 2005.

[2] Medingo was established by RDC in the fourth quarter of 2005.

[3] Enure has been consolidated since the beginning of the fourth quarter of 2005.

[4] Elron SW, Inc. ("ESW"), formerly Elron Software. ESW was liquidated as of December 31, 2004.

[5] Semiconductor Engineering Laboratories Ltd.("SELA") has been consolidated since the end of the second quarter of 2004.

Equity Method. Our main group companies held by us or through Elbit, DEP, Galil Medical and/or RDC accounted for under the equity method of accounting include:

Year ended December 31,					
2005			2004		
Given Imaging	Wavion	Pulsicom	Elbit Systems[1]	ChipX	Oncura
Oren Semiconductor[2]	Notal Vision	CellAct	Given Imaging	Wavion	Pulsicom
NetVision	AMT		Oren Semiconductor	Notal Vision	CellAct
ChipX	Oncura		NetVision	AMT	SELA[3]

[1] Sold on July 28, 2004.

[2] Sold on June 10, 2005.

[3] Through the end of the second quarter of 2004.

Cost. Our main group companies held by us accounted for under the cost method of accounting include:

Year ended December 31,		
2005		2004
Jordan Valley	BrainsGate	Jordan Valley
Impliant	NuLens	Impliant
Teledata		

RESULTS OF OPERATIONS

Year Ended December 31, 2005 compared to Year Ended December 31, 2004.

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

	Year ended December 31,	
	2005	2004
	(millions of $, except per share data)	
Net income (loss)	47.3	84.1
Net income (loss) per share	1.61	2.87

The net income we reported in 2005 was mainly due to the following gains from changes in holding and dispositions of group companies:

(i) a gain, net of tax, of approximately $45.4 million resulting from the sale of Partner's shares in consideration for $94.0 million. This gain includes approximately $9.4 million, resulting from a decrease in our previous valuation allowance in respect of losses incurred in prior periods, following our receipt of a final tax assessment;

(ii) a gain, net of tax, of approximately $17.2 million resulting from the sale of Oren's shares in consideration for $20.3 million in cash and Zoran shares;

(iii) a gain of approximately $3.0 million from the decrease in our interest in NetVision following its initial public offering; and

(iv) a tax benefit of $5 million, resulting from a decrease in our previous valuation allowance in respect of losses incurred on our investment in the ET group.

The above gains were offset by losses, net, which we recorded with respect to our group companies in the amount of $23.0 million in 2005.

The net income we reported in 2004 included the following gains from changes in holding and dispositions of group companies:

(i) a gain, net of tax, of approximately $91.5 million resulting from the sale of our holdings in Elbit Systems for approximately $196.6 million. This gain includes approximately $21.6 million resulting from a decrease in our previous valuation allowance in respect of losses incurred in prior periods following our receipt of a final tax assessment;

(ii) a gain, net of tax and minority interest, of approximately $6.7 million resulting from the sale of Given Imaging's shares by RDC and the decrease in our direct and indirect interest in Given Imaging following the completion of Given Imaging's secondary public offering;

(iii) a gain of approximately $5.3 million resulting from the sale of our shares in KIT eLearning; and

(iv) a gain, net after tax, of approximately $3.6 million resulting from the sale of 854,701 Zix Corporation shares (which were received as consideration for the sale of ESW business in 2003) for aggregate consideration of $8.1 million;.

The above gains were offset by losses, net, which we recorded with respect to our group companies in the amount of $23.3 million in 2004.

Subsequent to the sale of the ET group we operate in one segment. The following table summarizes our operating results:

	Year ended December 31,	
	2005	2004
	(millions of $)	
Net revenues	12.6	11.3
Net loss from equity investments	(17.5)	(10.5)
Gains from disposal of business and affiliated companies and changes in holdings in affiliated companies	23.3	132.4
Other income, net	58.6	4.7
Finance income, net	5.5	1.4
Total income	82.5	139.3
Cost of revenues	7.2	6.3
Operating expenses*	18.5	17.0
Amortization of other assets	0.4	0.1
Impairment of long-lived assets	-	4.2
Total costs and expenses	26.1	27.6
Gain from continuing operations before income taxes	56.5	111.7
Tax benefit (Income taxes)	(10.5)	(15.1)
Minority interest	5.2	(4.1)
Net income from continuing operations	51.2	92.5
Discontinued operations of the ET group (**)	(3.9)	(7.9)
Discontinued operations of ESW	-	(0.5)
Net income	47.3	84.1

* Excluding amortization of intangible assets which are presented separately.

** As described under "MAJOR TRANSACTIONS AND NEW INVESTMENTS" in December 2005, we sold all our holdings in the ET group which was focused on telecom network management products and services, and accordingly the current period results of operations and the gain on the sale have been classified as discontinued operations, and prior periods

results have been reclassified accordingly. The following table sets forth the composition of the discontinued operating results of the ET group:

	Year ended December 31,	
	2005	2004
	(millions of $)	
Loss from operations	(4.1)	(7.9)
Gain on disposal	0.2	-
Loss from Discontinued operations	(3.9)	(7.9)

The decrease in loss from operations in the reported period was primarily due to an impairment charge of long lived assets and goodwill in the aggregate amount of $4.9 million which was recorded in 2004. In 2005 a goodwill impairment in the amount of $1.3 million was recorded.

Income

Net revenues. Net revenues consisted of sales of products and services by our subsidiaries, mainly Galil Medical and SELA. The following table sets forth these revenues:

	Year ended December 31,	
	2005	2004
	(millions of $)	
Galil Medical	8.3	7.6
SELA[1]	4.2	3.3
Other	0.1	0.4
	12.6	11.3

[1] SELA's results have been consolidated since July 1, 2004.

In 2005, Galil Medical recorded revenues of $8.3 million, compared to $7.6 million in 2004. Galil Medical's revenues derived mainly from the supply of cryo products and R&D services to Oncura, in which it has a 25% ownership interest.

SELA recorded revenues of $4.2 million in 2005, compared to $5.1 million in 2004 (of which $3.3 million were devided in the second half of 2004).

Share in net losses of affiliated companies. Our share in net losses of affiliated companies resulted from our holdings in certain investments that are accounted for under the equity method (see above under "Basis of Presentation"). Our share in net losses of affiliated companies amounted to $17.5 million in 2005, compared to $10.5 million in 2004. The increase in our share in net losses of our affiliated companies is primarily due to the sale of our holding in Elbit Systems in the third quarter of 2004, which positively contributed $4.7 million to our net income in the first half of 2004 and due to impairment charges of $5.1 million, with respect to our investment in Oncura (through Galil Medical) in 2005.

Highlights of the Results of Operations of Our Major Affiliates:

Given Imaging (Nasdaq: GIVN) (a 19.4% holding directly and indirectly through RDC). Given Imaging Ltd. ("Given Imaging"), a medical device company that develops, manufactures and markets innovative diagnostic systems for visualizing the gastrointestinal tract, using a disposable miniature swallowable video capsules, recorded revenues of $86.8

million in 2005, an increase of approximately 35% over the revenues recorded in 2004 of $65.0 million. The increase in revenues resulted primarily from the increase in sales of Given PillCam video capsule for the small bowel. Given Imaging's net income in 2005 was $6.3 million, compared to $2.9 million in 2004. Given Imaging's net income in 2005 included a special provision recorded in the second quarter, net of tax benefits, of $1.2 million for uncollectable sales tax related at its U.S. subsidiary.

Oncura (a 25% holding by Galil). Oncura, which markets and sells therapeutic device systems and related consumables used primarily in the performance of minimally-invasive, urologic cancer treatment, recorded revenues in 2005 of approximately $72.1 million compared to $68.8 million in 2004 and its net loss amounted to $6.2 million compared to $2.2 million in 2004. The increase in the net loss resulted primarily due to the increase in operating expenses, mainly selling and marketing expenses. In light of Oncura's results of operations, an impairment charge of $5.1 million was recorded in 2005 ($2.1 million after minority interest). Both Galil and GE provided a letter to Oncura in which they confirmed their intention to continue providing financial support to Oncura through March 1, 2007 or such later date, as may be agreed by Oncura's shareholders.

NetVision (a 39% holding) (TASE: NTSN). NetVision's revenues increased in 2005 by 12.6% to $74.3 million (of which $3.3 million derived from international telephony services) from $66.0 million in 2004 and its customer base at December 31, 2005 reached approximately 425,000 (of which approximately 272,000 were broadband) compared to 390,000 at the end of 2004 (of which approximately 225,000 were broadband). NetVision's operating income in 2005 increased by 43.3% to $9.5 million, compared to $6.6 million in 2004 and its net income amounted to $5.4 million compared to $3.9 million in 2004. NetVision's operating currency is the New Israeli Shekel (NIS) and accordingly, all figures above are translations for convenience purposes of NetVision's NIS figures into US dollars at the representative rate of exchange prevailing at December 31, 2005 according to which $1.00 equaled NIS 4.603.
NetVision's future period results will continue to be affected mainly by the highly competitive Internet broadband market environment in Israel, and whether Internet prices will continue to decrease or will stabilize, as well as from costs incurred in connection with the highly competitive international telephony services market in Israel.
On May 19, 2005, NetVision completed its initial public offering on the TASE of shares and convertible securities in consideration for aggregate immediate net proceeds of approximately $31 million (see above under "MAJOR TRANSACTIONS AND NEW INVESTMENTS").

Wavion (a 38% holding). Wavion is a developer of broadband wireless access systems for Wi-Fi networks. Wavion's net loss amounted to $6.3 million in 2005 the same as in 2004, which includes mainly expenses relating to the development of its product.

ChipX (a 27% holding). ChipX is a manufacturer of late stage programmable application-specific integrated circuits, or structured ASICs. ChipX's revenues in 2005 amounted to $14.7 million, compared to $16.2 million in 2004, and its net loss amounted to $6.3 million, compared to $5.6 million in 2004. Revenues decreased as ChipX shifted from its old product to the new Structured ASIC products.

AMT (a 42% holding). The AMT group develops technologies and products based on amorphous metals. AMT's consolidated revenues in 2005, amounted to $3.6 million, compared to $2.6 million in 2004 and its consolidated net loss amounted to $3.9 million, compared to $3.0 million in 2004. AMT's main subsidiary, AHT, which uses amorphous metals for heating products, recorded revenues of $2.6 million in 2005, compared to $1.2 million in 2004, and recorded a net loss of $1.9 million in 2005, the same as in 2004.

We expect that most of our group companies as well as new companies in which we will invest will continue to recognize losses in future periods, as they invest significant resources in research and development and sales and marketing activities and have not yet generated significant revenues. Our results of operations will therefore be affected by the extent of our share in their net losses (to the extent they are reported under the equity or consolidation method of accounting).

Results of operations of significant group companies which are accounted for other than under the equity method of accounting and whose results do not affect our results of operations.

Partner (Nasdaq: PTNR) (a 2% holding as of December 31, 2005). Partner is a Global System for Mobile Communications, or GSM, mobile telephone network operator in Israel. Our investment in Partner is accounted for as available-for-sale securities. Following the sale of most of our shares in Partner during the second quarter of 2005 (see above under "TRANSACTIONS AND NEW INVESTMENTS"), the market value of our investment in Partner as of December 31, 2005 amounted to $26.0 million. Almost all of the remaining Partner shares held by us, amounting to approximately 3.1 million shares, are subject to certain transfer restrictions under Partner's Israeli communications license but are no longer pledged to Partner's lending banks.

In 2005, Partner recorded revenues of $1,113 million compared to $1,117 million in 2004 and its net income amounted to $77 million, compared to $102.4 million in 2004. Partner's subscriber base as of December 31, 2005 was 2,529,000 compared to 2,340,000 at the end of 2004. Partner's operating currency is the NIS and accordingly, all figures above are translations for convenience purposes of Partner's NIS figures into US dollars at the representative rate of exchange prevailing at December 31, 2005 according to which $1.00 equaled NIS 4.603.

Teledata (a 21% holding). Teledata provides innovative access products and solutions for both traditional and next generation networks to telecom operators and service providers. Teledata's revenues in 2005 amounted to $55.9 million compared to $38.9 million in 2004 and its net income amounted to $1.8 million in 2005 compared to a net loss of $2.5 million in 2004. The increase in revenues resulted mainly from an increase in revenues from existing customers.

Jordan Valley (a 28% holding). Jordan Valley is engaged in developing solutions for advanced in-line thin film metrology for the semiconductor industry. Jordan Valley's revenues in 2005 increased to $10.4 million from $8.3 million in 2004, primarily due to the launch of new products. Jordan Valley's net loss in 2005 was $0.1 million, compared to $0.7 million in 2004.

Gains from Disposal of Business and Affiliated Companies and Changes in Holdings in Affiliated Companies.

Gains from disposal of businesses and affiliated companies and changes in our holdings in affiliated companies in 2005 amounted to $23.3 million, compared to $132.4 million in 2004. The gain in 2005 resulted primarily from the following: (i) a gain of approximately $19.7 million (which after income taxes amounted to $17.2 million) resulting from the sale of Oren's shares in consideration for $20.3 million; (ii) a gain of approximately $3.0 million from the decrease in our interest in NetVision following its initial public offering; and (iii) a gain of $1.2 million (which after minority interest and income taxes amounted to $0.5 million) resulting from the exercise of a call option granted to a former senior executive of RDC to purchase 70,200 shares of Given Imaging for the aggregate exercise price of approximately $12 thousand.

The gain recorded in 2004 resulted primarily from the following: (i) a $104.6 million gain (which after income taxes amounted to $91.5 million) resulting from the sale of our holding in Elbit Systems; (ii) a $15.2 million gain (which after minority interest and income taxes amounted to $6.7 million) resulting from the sale of 300,000 shares of Given Imaging by RDC and the decrease in our direct and indirect interest in Given Imaging following Given Imaging's secondary public

offering; and (iii) a gain of $5.8 million (which after minority interest and income taxes amounted to $1.4 million) resulting from the purchase by RDC of treasury shares amounting to approximately 3% of its outstanding shares from one of its shareholders (a former senior executive of RDC) in consideration for distribution of 200,000 shares of Given Imaging; and (iv) a $5.3 million gain from the sale of our share of KIT eLearning, for a cash payment of $9.4 million (from which we received $5.7 million) and a future payment of up to an additional $10.0 million based on future earnings of KIT in 2006 and 2007 (from which our share will be up to $5.7 million).

Other Income, net. Other income, net, amounted to $ 58.6 million in 2005 compared to $4.7 million in 2004. The gain in 2005 was primarily due to the following (i) a $56.4 million gain (which after income taxes amounted to $45.4 million) from the sale of 12,765,190 shares of Partner for approximately $94.0 million; (ii) a gain of $1.1 million ($0.7 million net of tax) from the sale of Zoran's shares received as part of the consideration for Oren's shares; and (iii) a gain from a dividend received from Partner in the amount of $0.4 million. The gain in 2004 resulted mainly from a $5.4 million gain, before tax, from the sale of 854,701 shares of Zix which were received in consideration for ESW's assets and business sold to Zix in 2003.

Expenses

Cost of revenues. Cost of revenues consisted primarily of expenses related to salaries and hardware associated with delivering products and services of our subsidiaries, mainly Galil Medical and SELA (whose results have been consolidated since July 1, 2004). Cost of revenues in 2005 amounted to $7.2 million, compared to $6.3 million in 2004.

Operating expenses. Operating expenses are comprised of research and development expenses, sales and marketing and general and administrative expenses of our and RDC's corporate operations and of our subsidiaries, mainly Galil Medical, SELA, Starling and 3DV. The following table sets forth operating expenses (excluding amortization of intangible assets which is presented separately and amounted to $0.4 million in 2005 and $0.1 million in 2004, and which also constitute part of operating expenses under US GAAP but for presentation purposes are included as a separate item):

	Year ended December 31,	
	2005	2004
	(millions of $)	
Corporate	6.9	7.3
Galil Medical	3.5	2.8
SELA[1]	3.1	1.6
Starling	2.4	1.6
3DV	1.9	1.2
Other (mainly RDC)	0.7	2.5
	18.5	17.0

[1] SELA's results have been consolidated since July 1, 2004

Operating expenses of Galil Medical in 2005 amounted to $3.5 million, as compared to $2.8 million in 2004 and its operating results amounted to an operating loss of $0.5 million compared to an operating income of $0.1 million in 2004. The increase in operating loss is due to the commencement by Galil of the development of its cryotherapy technology for application in the women's health field at the end of 2004. In November 2005, Galil Medical's Cryo products received FDA clearance for the treatment of breast fibroadenoma (non cancerous breast lumps).

SELA's operating expenses amounted to $3.1 million in 2005, compared to $2.9 million in 2004 (of which $1.6 million was incurred in the second half of 2004) and its operating loss amounted to $0.7 million compared to an operating income of $0.4 million in 2004, resulting from the decrease in revenues recognized in 2005.

The decrease in operating expenses of the other companies resulted mainly from income recorded in RDC in 2005 with respect to employee stock option plans resulting from the decrease in the fair value of call options to purchase shares of affiliated companies.

Finance income, net. Finance income, net, amounted in 2005 to $5.5 million, compared to $1.4 million in 2004. The increase is mainly due to higher cash resources during the period as a result of the sale of our holding in Elbit Systems in 2004 for approximately $197 million and from the sale of Partner shares in the second quarter of 2005 for approximately $94.0 million. Income from interest in future periods is expected to decrease due to a decrease in cash resources mainly as a result of a cash dividend payment on September 27, 2005.

Income Taxes. Income taxes, net, amounted in 2005 to $10.5 million which included mainly $11.0 million of income taxes with respect to the gain resulted from the sale of Partner shares (which includes an offset of $9.4 million due to the reduction in our previous valuation allowance with respect to losses incurred in prior periods following our receipt of a final tax assessment) and $2.4 million resulting from the sale of Oren shares. These were partially offset mainly by a tax benefit of $5 million, resulting from a decrease in our previous valuation allowance due to the sale of the ET group. Income taxes, net, in 2004 were $15.1 million resulting mainly from the sale of our holding in Elbit Systems, the secondary public offering of Given Imaging, the purchase of treasury stock in RDC in consideration for distribution of Given Imaging's shares and the sale of Zix shares. Income taxes were partially offset by a tax benefit in the amount of $2.9 million due to the change in the Israeli tax rate enacted in 2004 and a $1.5 million tax benefit related to the impairment of future royalties to be received by MediaGate.

LIQUIDITY AND CAPITAL RESOURCES

Consolidated cash, debentures and deposits at December 31, 2005, were approximately $143.8 million compared with $188.1 million at December 31, 2004. At December 31, 2005, corporate cash, debentures and deposits were $133.8 million compared with $175.7 million at December 31, 2004.

The main sources of corporate cash and other liquid instruments in 2005, were $94.0 million of proceeds from the sale of Partner shares, $10.5 million cash proceeds from the sale of our shares in Oren, $8.8 million from the sale of Zoran's shares that were received as part of the consideration for Oren's shares; $2.2 million repayment of loan by NetVision and $2.1 million proceeds from the sale of the ET group.

The main uses of corporate cash and other liquid instruments in 2005, were an $88.5 million dividend paid, income tax payments of approximately $27.1 million (mainly with respect to the sale of Elbit Systems in 2004 and Partner in 2005) and $40.5 million of investments (including loans) in new and existing group companies as detailed below (in millions of $):

Teledata	16.0
Brainsgate	6.9
Enure	4.0
Nulens	1.7
Starling	1.5
Wavion	1.4
Jordan Valley	1.4
AMT	1.4
Impliant	1.0
Galil Medical	0.8
3DV	0.7
Other	3.7
	40.5

In addition during 2005, RDC invested an amount of $6.1 million, which included $0.6 million in a new company established at the end of 2005, namely Medingo Ltd. which is developing a miniature disposable insulin dispenser for insulin dependent diabetic patients.

Consolidated working capital at December 31, 2005 amounted to $136.2 million compared to $162.2 million at December 31, 2004. The decrease is mainly due to the decrease in corporate cash and other liquid instruments.

At December 31, 2005, we and our subsidiaries had no material contractual obligations which are expected to affect our consolidated cash flow in future periods, except for lease obligations and payments of bank credits, bank loans and loans from others, including short term loans taken by our subsidiaries, in each case due in future periods as set forth in the table below (in million of $):

Type of Obligation	2006	2007	2008	2009	Total
Loans from banks	3.8	-	-	-	3.8
Loans from other	2.1	1.4	-	-	3.5
leases	0.8	0.7	0.4	0.2	2.1

Consolidated loans at December 31, 2005, were approximately $7.3 million, compared to $7.5 million at December 31, 2004. In the first quarter of 2006 MediaGate's bank loan in the amount of approximately $2.8 million was extingished. As a result, we will record in the first quarter of 2006 a gain of approximately $2.7 million.

Almost all of the remaining Partner shares held by us as of December 31, 2005, amounting to approximately 3.1 million shares, are subject to certain transfer restrictions under Partner's Israeli communications license but are no longer pledged to Partner's lending banks.

Subsequent to December 31, 2005 and through March 13, 2006, we invested an additional aggregate amount of approximately $6.6. million, which mainly included $3.5 million in Safend.

See above under "MAJOR TRANSACTIONS AND NEW INVESTMENTS" regarding an agreement to purchase shares of Partner.

Our investment policy for managing our funds is in general to invest in bank deposits and U.S. government securities with high liquidity.

We believe that our existing capital will be sufficient to fund our and our subsidiaries' operations and our investment plan in existing and new companies for at least the next twelve months.
Shareholders' equity at December 31, 2005, was approximately $302.1 million, representing approximately 85% of the total assets compared with $389.1 million representing approximately 78% of total assets at December 31, 2004. The decrease in the shareholders' equity is mainly due to our dividend distribution in 2005.

QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK

Market risks relating to our operations result primarily from changes in interest rates, exchange rates and equity prices. In order to limit our exposure, we may enter, from time to time, into various derivative transactions. Our objective is to reduce exposure and fluctuations in earnings and cash flows associated with changes in interest rates, foreign currency rates and equity prices. We do not use financial instruments for trading purposes. It is our policy and practice to use derivative financial instruments only to limit exposure. As part of this policy, in 2005, we hedged the dollar value of the expected proceeds from the sale of our shares in Partner by the purchase of call options and by selling put options, at a dollar/NIS exchange rate ranging from $4.36 to $4.44 for a period of 81 days. This transaction had no material effect on our results of operations.

Interest Rate Risks. We are exposed to market risks resulting from changes in interest rates, relating primarily to our debentures and deposits. We do not use derivative financial instruments to limit exposure to interest rate risk. As of December 31, 2005, we held US government debentures with a market value of approximately $62.6 million. The market value of the debentures depends on changes and expectations of changes in the interest rates in the US and general market conditions in the US. At December 31, 2005, all of our debentures and short-term deposits were fixed rate based with an average annual rate of 3.7% and a weighted average maturity of approximately 1.7 years. .In 2005, as a result of increase in interest rates, we recorded an other than temporary decline in value, net of tax, of approximately $0.6 million on debentures held by us.

Exchange Rate Risk. Since most of our group companies are Israeli-related, our main exposure, if any, results from changes in the exchange rate between the New Israeli Shekel and the U.S. dollar. Our functional currency, as well as that of our principal subsidiaries and affiliated companies, is the U.S. dollar. Our policy is to reduce exposure to exchange rate fluctuations by having most of our and our subsidiaries' assets and liabilities, as well as most of the revenues and expenditures in U.S. dollars, or U.S. dollar linked. Therefore, we believe that the potential loss that would result from an increase or decrease in the exchange rate is immaterial to our business and net assets. See above regarding the hedging of the dollar value of the proceeds from the sale of our shares in Partner.

Equity Price Risk. We are exposed to fluctuations in the equity price of our holdings in publicly traded companies. At December 31, 2005 we directly and indirectly held shares of publicly traded companies, mainly, Given Imaging, Partner, and NetVision. Stock prices in the industries of these companies, and of these companies themselves, have experienced significant historical volatility. Changes in the market value of our publicly traded holdings, including holdings through our affiliates, which are accounted under the equity method of accounting or as available-for-sale securities will not affect our results of operations but may have a significant effect on our market value. We view the risks of reduction in market price of these companies as part of our business risks and we examine, from time to time, the possibility of having a partial hedge against equity price risks. Based on closing market prices at December 31, 2005, the market value of our holdings in public securities was approximately $197.0 million. At December 31, 2005 no financial instruments are used to hedge against equity price fluctuations.

Changes in the market value of our available-for-sale securities (Partner and EVS) are reported in other comprehensive income, which is included as a component of shareholders' equity, and not as part of our results of operations. The market value of our available-for-sale securities as of December 31, 2005 amounted to $27.7 million.

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