

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

**CONDENSED INTERIM CONSOLIDATED
FINANCIAL STATEMENTS**

AS OF JUNE 30, 2011

(Unaudited)

(In thousands of U.S. dollars)

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ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

U.S. dollars (in thousands)

	June 30, 2011	December 31, 2010
	(Unaudited)	(Audited)
CURRENT ASSETS:		
Cash and cash equivalents	\$ 68,830	\$ 151,059
Short-term bank deposits and trading marketable securities	32,353	63,486
Trade and unbilled receivables, net	743,246	702,364
Other receivables and prepaid expenses	196,843	166,124
Inventories, net of customer advances	738,872	665,270
Total current assets	<u>1,780,144</u>	<u>1,748,303</u>
LONG-TERM INVESTMENTS AND RECEIVABLES:		
Investments in affiliated companies, partnership and other companies	92,586	88,116
Available for sale marketable securities	6,130	7,179
Long-term trade and unbilled receivables	108,832	90,343
Long-term bank deposits and other receivables	45,715	44,401
Deferred income taxes, net	28,686	29,892
Severance pay fund	319,355	302,351
	<u>601,304</u>	<u>562,282</u>
PROPERTY, PLANT AND EQUIPMENT, NET	<u>529,050</u>	<u>503,851</u>
GOODWILL	<u>498,705</u>	<u>483,071</u>
OTHER INTANGIBLE ASSETS, NET	<u>292,622</u>	<u>313,593</u>
	<u><u>\$ 3,701,825</u></u>	<u><u>\$ 3,611,100</u></u>

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

	June 30, 2011	December 31, 2010
	(Unaudited)	(Audited)
CURRENT LIABILITIES:		
Short-term bank credit and loans	\$ 36,223	\$ 15,115
Current maturities of long-term loans and Series A Notes	41,098	43,093
Trade payables	322,381	360,736
Other payables and accrued expenses	663,609	645,146
Customers advances in excess of costs incurred on contracts in progress	395,320	302,691
Total current liabilities	<u>1,458,631</u>	<u>1,366,781</u>
LONG-TERM LIABILITIES:		
Long-term loans, net of current maturities	354,862	292,039
Series A Notes and convertible debentures, net of current maturities	247,019	273,357
Accrued termination liability	418,661	395,303
Deferred income taxes and tax liability, net	52,864	55,936
Customers advances in excess of costs incurred on contracts in progress	144,266	177,191
Other long-term liabilities	55,224	45,042
	<u>1,272,896</u>	<u>1,238,868</u>
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Share capital:		
Ordinary shares of New Israeli Shekels (NIS) 1 par value;		
Authorized – 80,000 shares as of June 30, 2011		
and December 31, 2010;		
Issued 43,203,349 and 43,102,261 shares as		
of June 30, 2011 and December 31, 2010, respectively;		
Outstanding 42,794,428 and 42,693,340 shares as of June 30,		
2011 and December 31, 2010, respectively		
	12,079	12,050
Additional paid-in capital	229,536	281,594
Treasury shares - 408,921 shares as of June 30, 2011 and		
December 31, 2010	(4,321)	(4,321)
Accumulated other comprehensive loss	(25,831)	(18,460)
Retained earnings	731,818	695,830
Total Elbit Systems Ltd. shareholders' equity	<u>943,281</u>	<u>966,693</u>
Non-controlling interests	27,017	38,758
	<u>970,298</u>	<u>1,005,451</u>
Total liabilities and shareholders' equity	<u>\$ 3,701,825</u>	<u>\$ 3,611,100</u>

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

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

	Six months ended June 30,		Three months ended June 30,		Year ended December 31,
	2011	2010	2011	2010	2010
	(Unaudited)		(Unaudited)		(Audited)
Revenues	\$ 1,311,890	\$ 1,221,478	\$ 691,632	\$ 603,277	\$ 2,670,133
Cost of revenues	925,710	853,372	491,097	419,716	1,872,263
Gross profit	<u>386,180</u>	<u>368,106</u>	<u>200,535</u>	<u>183,561</u>	<u>797,870</u>
Operating expenses:					
Research and development, net	109,603	109,511	55,389	56,846	234,131
Marketing and selling	112,428	104,931	57,441	50,336	229,942
General and administrative	70,595	60,141	35,085	32,056	131,200
Other income, net	-	(4,756)	-	(4,756)	(4,756)
Total operating expenses	<u>292,626</u>	<u>269,827</u>	<u>147,915</u>	<u>134,482</u>	<u>590,517</u>
Operating income	93,554	98,279	52,620	49,079	207,353
Financial expenses, net	(20,012)	(4,137)	(9,350)	(1,002)	(21,251)
Other income, net	374	13,089	180	108	13,259
Income before taxes on income	73,916	107,231	43,450	48,185	199,361
Taxes on income	10,719	16,816	5,419	6,489	24,037
	<u>63,197</u>	<u>90,415</u>	<u>38,031</u>	<u>41,696</u>	<u>175,324</u>
Equity in net earnings of affiliated companies and partnership	6,151	9,301	2,400	5,389	19,343
Consolidated net income	<u>69,348</u>	<u>99,716</u>	<u>40,431</u>	<u>47,085</u>	<u>194,667</u>
Less: net income attributable to non-controlling interests	<u>(2,524)</u>	<u>(5,155)</u>	<u>(1,536)</u>	<u>(2,306)</u>	<u>(11,169)</u>
Net income attributable to Elbit Systems Ltd.'s shareholders	<u>\$ 66,824</u>	<u>\$ 94,561</u>	<u>\$ 38,895</u>	<u>\$ 44,779</u>	<u>\$ 183,498</u>
Earnings per share attributable to Elbit Systems Ltd.'s shareholders					
Basic net earnings per share	<u>\$ 1.56</u>	<u>\$ 2.22</u>	<u>\$ 0.91</u>	<u>\$ 1.05</u>	<u>\$ 4.30</u>
Diluted net earnings per share	<u>\$ 1.55</u>	<u>\$ 2.19</u>	<u>\$ 0.90</u>	<u>\$ 1.04</u>	<u>\$ 4.25</u>
Number of shares used in computation of basic net earnings per share	<u>42,756</u>	<u>42,611</u>	<u>42,780</u>	<u>42,645</u>	<u>42,645</u>
Number of shares used in computation of diluted net earnings per share	<u>43,232</u>	<u>43,257</u>	<u>43,248</u>	<u>43,234</u>	<u>43,217</u>

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

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

	Number of Outstanding Shares	Share Capital	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury shares	Non- controlling interest	Total shareholders' equity	Total comprehensive income
Balance as of January 1, 2010	42,530,895	\$ 12,006	\$ 272,127	\$ (22,413)	\$ 575,469	\$ (4,321)	\$ 24,326	\$ 857,194	
Exercise of options	162,445	44	3,546	-	-	-	-	3,590	
Stock-based compensation	-	-	5,211	-	-	-	-	5,211	
Tax benefit in respect of options exercised	-	-	710	-	-	-	-	710	
Dividends paid	-	-	-	-	(63,137)	-	-	(63,137)	
Fair value of non-controlling interests related to the acquisition of ITL	-	-	-	-	-	-	4,298	4,298	
Other comprehensive income, net of tax:									
Unrealized gain on derivative instruments, net of \$308 tax expense	-	-	-	6,668	-	-	119	6,787	\$ 6,787
Foreign currency translation differences	-	-	-	2,991	-	-	(1,154)	1,837	1,837
Unrealized pension loss, net of \$1,119 tax income	-	-	-	(2,781)	-	-	-	(2,781)	(2,781)
Unrealized loss on available for sale securities, net of \$990 tax income	-	-	-	(2,925)	-	-	-	(2,925)	(2,925)
Net income attributable to non-controlling interests	-	-	-	-	-	-	11,169	11,169	11,169
Net income attributable to Elbit Systems Ltd. shareholders	-	-	-	-	183,498	-	-	183,498	183,498
Total comprehensive income					183,498	-	-	183,498	183,498
Balance as of December 31, 2010	42,693,340	\$ 12,050	\$ 281,594	\$ (18,460)	\$ 695,830	\$ (4,321)	\$ 38,758	\$ 1,005,451	\$ 197,585
Exercise of options	101,088	29	2,485	-	-	-	-	2,514	
Stock based compensation	-	-	599	-	-	-	-	599	
Dividends paid	-	-	-	-	(30,836)	-	-	(30,836)	
Purchase of subsidiaries shares from non-controlling interest	-	-	(57,001)	-	-	-	(16,064)	(73,065)	
Sale of non-controlling interest of subsidiary	-	-	1,859	-	-	-	206	2,065	
Other comprehensive income, net of tax:									
Unrealized loss derivative instruments, net of \$171 tax income	-	-	-	(6,081)	-	-	-	(6,081)	\$ (6,081)
Foreign currency translation differences	-	-	-	(185)	-	-	1,593	1,408	1,408
Unrealized pension loss, net of \$211 tax expense	-	-	-	(890)	-	-	-	(890)	(890)
Unrealized loss on available for sale securities, net of \$437 tax income	-	-	-	(215)	-	-	-	(215)	(215)
Net income attributable to non-controlling interests	-	-	-	-	-	-	2,524	2,524	2,524
Net income attributable to Elbit Systems Ltd. shareholders	-	-	-	-	66,824	-	-	66,824	66,824
Total comprehensive income					66,824	-	-	66,824	66,824
Balance as of June 30, 2011 (Unaudited)	42,794,428	\$ 12,079	\$ 229,536	\$ (25,831)	\$ 731,818	\$ (4,321)	\$ 27,017	\$ 970,298	\$ 63,570

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars (in thousands)

	Six Months Ended		Year Ended
	June 30,		December 31,
	2011	2010	2010
	(Unaudited)		(Audited)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 69,348	\$ 99,716	\$ 194,667
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	74,632	60,988	132,141
Write-off impairment	520	717	1,284
Stock-based compensation	599	2,604	5,211
Amortization of Series A Notes discount and related issuance costs	247	25	167
Deferred income taxes and reserve, net	(7,426)	(9,029)	(28,162)
Gain on sale of property, plant and equipment	(690)	(698)	(2,600)
Gain on sale of investment	-	(18,713)	(19,151)
Equity in net earnings of affiliated companies and partnership, net of dividend received(*)	7,956	(929)	(8,418)
Changes in operating assets and liabilities, net of amounts acquired:			
Increase in short and long-term trade receivables, and prepaid expenses	(87,410)	(3,980)	(84,708)
Increase in inventories, net	(72,966)	(44,993)	(49,724)
Increase (decrease) in trade payables, other payables and accrued expenses	(20,493)	6,163	76,383
Severance, pension and termination indemnities, net	5,464	(212)	4,160
Increase (decrease) in advances received from customers	53,533	9,968	(36,396)
Net cash provided by operating activities	<u>23,314</u>	<u>101,627</u>	<u>184,854</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant and equipment	(73,444)	(67,484)	(138,644)
Acquisitions of subsidiaries and business operations (Schedule A)	(12,173)	(34,566)	(229,556)
Investments in affiliated companies and other companies	(6,919)	(59)	(4,956)
Proceed from sale of property, plant and equipment	4,983	5,139	11,841
Proceed from sale of investments	-	12,751	27,941
Investment in long-term deposits	(589)	(8,302)	(14,484)
Proceeds from sale of long-term deposits	3,600	15,020	30,240
Investment in short-term deposits and available for sale securities	(85,486)	(48,248)	(189,345)
Proceeds from sale of short-term deposits and available for sale securities	115,706	64,264	252,550
Net cash used in investing activities	<u>(54,322)</u>	<u>(61,485)</u>	<u>(254,413)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from exercise of options	2,514	2,908	3,590
Purchase of non-controlling interests, net	(71,000)	-	-
Repayment of long-term bank loans	(65,085)	(243,525)	(488,657)
Proceeds from long-term bank loans	126,410	55,000	387,692
Proceeds from issuance of Series A Notes	-	283,213	283,213
Series A Notes issuance costs	-	(2,163)	(2,530)
Dividends paid	(30,836)	(32,503)	(63,137)
Tax benefit in respect of options exercised	-	-	710
Repayment of Series A Notes	(32,211)	-	-
Repurchase of convertible debentures	(2,121)	-	-
Change in short-term bank credit and loans, net	21,108	-	(40,972)
Net cash provided by (used in) financing activities	<u>(51,221)</u>	<u>62,930</u>	<u>79,909</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(82,229)	103,072	10,350
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	151,059	140,709	140,709
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	<u>\$ 68,830</u>	<u>\$ 243,781</u>	<u>\$ 151,059</u>
* Dividend received	<u>\$ 14,107</u>	<u>\$ 8,372</u>	<u>\$ 10,925</u>

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars (in thousands)

	Six months ended June 30,		Year ended December 31,
	2011	2010	2010
	(Unaudited)		(Audited)
SCHEDULE A:			
Acquisitions of subsidiaries and business operations (*)			
Estimated net fair value of assets acquired and liabilities assumed at the date of acquisition was as follows:			
Working capital (deficit), net (excluding cash and cash equivalents)	\$ 306	\$ 1,360	\$ (57,937)
Property, plant and equipment	1,938	1,565	56,233
Other long-term assets	-	1,157	16,008
Goodwill and other intangible assets	17,993	35,613	261,910
Deferred income taxes	(1,171)	(3,449)	(15,515)
Long-term liabilities	(6,873)	(1,680)	(26,845)
Non controlling interest	-	-	(4,298)
	\$ 12,173	\$ 34,566	\$ 229,556

(*) See Note 1(B), as well as Notes 1(D) and 1(E) in the annual audited consolidated financial statements as of December 31, 2010.

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

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 1 - GENERAL

- A. The accompanying interim condensed financial statements have been prepared in a condensed format as of June 30, 2011, and for the three and six months then ended in accordance with United States generally accepted accounting principles ("U.S. GAAP") relating to the preparation of financial statements for interim periods. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. These condensed interim consolidated financial statements are unaudited and should be read in conjunction with the annual audited consolidated financial statements and accompanying notes as of December 31, 2010, included in the Company's annual report for the year ended December 31, 2010, filed on Form 20-F on March 14, 2011. The condensed interim consolidated financial statements reflect all adjustments, which are, in the opinion of management, necessary for a fair presentation. All such adjustments were of a normal recurring nature.

Operating results for the six-month period ended June 30, 2011, are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

- B. During the first six months of 2011 the Company completed the following acquisitions:
- (1) On February 9, 2011, the Company completed its cash tender offer (the "Tender Offer") to purchase all of the ordinary shares of I.T.L Optronics Ltd. ("ITL"), which prior to the completion of the offer was a publicly traded company in Israel, held 87.85% by the Company. As a result, ITL became a private wholly-owned subsidiary. The total amount paid for the ITL shares, related to the offer, was approximately \$5,900 (approximately \$3.4 per share). As this was an equity transaction between the Company and ITL's non-controlling shareholders, the Company reduced its shareholders' equity for the excess cost over book value related to the minority interest in ITL.
 - (2) On February 22, 2011, the Company acquired the remaining 30% of the shares of Elisra Electronic Systems Ltd. ("Elisra") held by Elta Systems Ltd. ("Elta") for \$67,500. Following the acquisition, Elisra became a wholly-owned subsidiary of the Company. As this was an equity transaction between the Company and Elisra's non-controlling shareholders, the Company reduced its shareholders' equity for the excess cost over book value related to the minority interest in Elisra. Subsequently, Elisra changed its name to Elbit Systems EW and SIGINT - Elisra Ltd.
 - (3) On April 1, 2011, the Company acquired all of the shares of Elite Automotive Systems Ltd. ("Elite") for a purchase price of approximately \$8,200. The Company allocated the acquired assets and liabilities assumed, based on a preliminary Purchase Price Allocation ("PPA") performed by an independent advisor.
 - (4) On June 30, 2011, the Company completed the acquisition of C4 Security Ltd. ("C4") for a purchase price of approximately \$10,900, of which approximately \$6,900 is contingent consideration related to the occurrence of future events. The Company allocated the acquired assets and liabilities assumed, based on a preliminary PPA performed by an independent advisor.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 2 - SIGNIFICANT ACCOUNTING POLICIES

- A. The significant accounting policies followed in the preparation of these statements are identical to those applied in preparation of the latest annual consolidated financial statements, except as detailed in Note 2(C).
- B. 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 in the financial statements and accompanying notes. Actual results could differ from those estimates.
- C. REVENUE RECOGNITION – ARRANGEMENT WITH MULTIPLE DELIVERABLES
- The Company generates revenues principally from long-term contracts involving the design, development, manufacture and integration of defense systems and products. In addition, to a lesser extent, the Company provides support and services for such systems and products.
- On January 1, 2011, the Company adopted a new accounting standard, ASU 2009-12, "Revenue Recognition – Multiple-Deliverable Revenue Arrangements", that principally revised accounting guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and how consideration should be allocated. This standard applies to new or materially modified contracts entered into after January 1, 2011. The adoption of the revised accounting guidance did not have a material effect on the Company's financial results in the six-month period ended June 30, 2011. Further, had the Company earlier adopted the guidance at January 1, 2010, the guidance would not have a material effect on the Company's financial results in the six-month period ended June 30, 2010.
- D. RECENTLY ISSUED ACCOUNTING STANDARDS
- (1) In May 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS", which is effective for annual reporting periods beginning after December 15, 2011. This guidance amends certain accounting and disclosure requirements related to fair value measurements. Additional disclosure requirements in the update include: (1) for Level 3 fair value measurements, quantitative information about unobservable inputs used, a description of the valuation processes used by the entity, and a qualitative discussion about the sensitivity of the measurements to changes in the unobservable inputs; (2) for an entity's use of a non-financial asset that is different from the asset's highest and best use, the reason for the difference; (3) for financial instruments not measured at fair value but for which disclosure of fair value is required, the fair value hierarchy level in which the fair value measurements were determined; and (4) the disclosure of all transfers between Level 1 and Level 2 of the fair value hierarchy. The Company will adopt ASU 2011-04 on January 1, 2012. The Company is currently evaluating ASU 2011-04 and has not yet determined the impact that adoption will have on its consolidated financial statements.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

D. RECENTLY ISSUED ACCOUNTING STANDARDS (Cont.)

(2) In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income", which is effective for annual reporting periods beginning after December 15, 2011. Accordingly, the Company will adopt ASU 2011-05 on January 1, 2012. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. In addition, items of other comprehensive income that are reclassified to profit or loss are required to be presented separately on the face of the financial statements. This guidance is intended to increase the prominence of other comprehensive income in financial statements by requiring that such amounts be presented either in a single continuous statement of income and comprehensive income or separately in consecutive statements of income and comprehensive income. The adoption of ASU 2011-05 is not expected to have a material impact on the Company's financial position or results of operations.

Note 3 - INVENTORIES, NET OF ADVANCES

	June 30,	December 31,
	2011	2010
	(Unaudited)	(Audited)
Cost incurred on long-term contracts in progress	\$ 860,798	\$ 763,791
Raw materials	97,849	82,236
Advances to suppliers and subcontractors	53,737	50,839
	1,012,384	896,866
Less -		
Cost incurred on contracts in progress deducted from customer advances	71,835	55,957
Advances received from customers (*)	124,915	101,231
Provision for losses on long-term contracts	76,762	74,408
	\$ 738,872	\$ 665,270

(*) The Company has transferred legal title of inventories to certain customers as collateral for advances received. Advances are allocated to the relevant inventories on a per-project basis. In cases where advances are in excess of the inventories, the net amount is presented in customer advances.

Note 4 - SERIES A NOTES AND CONVERTIBLE DEBENTURES

	June 30,	December 31,
	2011	2010
Series A Notes ⁽¹⁾	\$ 289,898	\$ 309,946
Convertible debentures ⁽²⁾	1,103	2,993
Less -		
Current maturities	(32,190)	(33,574)
Carrying amount adjustments on Series A Notes ^(*)	(10,040)	(4,011)
Discount on Series A Notes	(1,752)	(1,997)
	\$ 247,019	\$ 273,357

(*) As a result of fair value hedge accounting.

The carrying value of the Series A Notes is adjusted for changes in the interest rates.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 4 - SERIES A NOTES AND CONVERTIBLE DEBENTURES (Cont.)

- (1) In June 2010, the Company issued Series A Notes in the aggregate principle amount of NIS 1.1 billion (approximately \$283,000), payable in 10 equal annual installments on June 30 of each of the years 2011 through 2020. The Series A Notes bear a fixed interest rate of 4.84% per annum, payable on June 30 and December 30 of each of the years 2010 through 2020. During the period ended June 30, 2011, the Company recorded \$3,023 as interest expenses. Amortization of discount and deferred financing costs amounted to \$247 for the six-month period ended June 30, 2011. On June 30, 2011, the Company paid the first installment of approximately \$32,200 (NIS 110 million) of the Series A Notes principle amount.

The Series A Notes (principal and interest) are not linked to any currency or index. The Series A Notes are unsecured, non convertible and do not restrict the Company's ability to issue additional notes of any class or distribute dividends in the future. There are no covenants on the Series A Notes. The Series A Notes are listed for trading on the Tel-Aviv Stock Exchange.

On May 3, 2011, Midroog Ltd., an Israeli rating agency, announced in its annual rating report that it continued to assign an "Aa1" rating (local scale) to Series A Notes issued by the Company.

As of June 30, 2011, the fair value of the Series A Notes, based on the quoted market price on the Tel-Aviv Stock Exchange, was approximately \$282,302.

The Company also entered into ten-year cross currency interest rate swap transactions in order to effectively hedge the effect of interest and exchange rate differences resulting from the NIS Series A Notes. Under the cross currency interest rate swaps, the Company receives fixed NIS at a rate of 4.84% on NIS 1.1 billion and pays floating six-month USD LIBOR + an average spread of 1.65% on \$287,000, which reflects the U.S. dollar value of the Series A Notes on the specific dates the transactions are entered. Both the debt and the swap instruments pay semi-annual coupons on June 30 and December 31. The purpose of these transactions is to convert the NIS fixed rate Series A Notes into USD LIBOR (6 months) floating rate obligations. As a result of these agreements, the Company is currently paying an effective interest rate of six-month LIBOR (0.457% at June 30, 2011) plus an average of 1.65% on the principal amount, as compared to the original 4.84% fixed rate. The above transactions qualify for fair value hedge accounting.

The gain or loss on the Series A Notes, attributable to the hedged benchmark interest rate risk (risk of change on the applicable NIS swap rate) and the offsetting gain or loss on the related interest rate swap for the period ended June 30, 2011 was \$5,977, net.

- (2) Convertible debentures were issued by ITL in July 2005. The convertible debentures bore a fixed interest of 4% per annum. The debentures were paid annually, and the last payment was in July 2011.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 5 - COMPUTATION OF BASIC AND DILUTED NET EARNINGS PER SHARE

	Six months ended June 30, 2011 (Unaudited)			Six months ended June 30, 2010 (Unaudited)			Year ended December 31, 2010		
	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per share amount	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per share amount	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per share amount
Basic net earnings	\$ 66,824	42,756	\$ 1.56	\$ 94,561	42,611	\$ 2.22	\$ 183,498	42,645	\$ 4.30
Effect of dilutive securities:									
Employee stock options	-	476		-	646		-	572	
Diluted net earnings	\$ 66,824	43,232	\$ 1.55	\$ 94,561	43,257	\$ 2.19	\$ 183,498	43,217	\$ 4.25

	Three months ended June 30, 2011 (unaudited)			Three months ended June 30, 2010 (Unaudited)		
	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per share amount	Net income to shareholders of ordinary shares	Weighted average number of shares (*)	Per share amount
Basic net earnings	\$ 38,895	42,780	\$ 0.91	\$ 44,779	42,645	\$ 1.05
Effect of dilutive securities:						
Employee stock options	-	468		-	589	
Diluted net earnings	\$ 38,895	43,248	\$ 0.90	\$ 44,779	43,234	\$ 1.04

(*) In thousands

Note 6 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company measures the fair value of financial instruments as described in Note 2(AB) of its 2010 annual audited financial statements.

Assets and liabilities measured at fair value on a recurring basis and other level with the fair value hierarchy are summarized below:

Description of Assets	Fair value measurement at June 30, 2011 (Unaudited) using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:			
ARS and CDOs	\$ -	\$ -	\$ 6,130
Foreign currency forward and option contracts	-	24,279	172
Cross-currency interest rate swaps	-	23,862	-
Liabilities			
Foreign currency derivative contracts	-	(14,623)	-
Total	\$ -	\$ 33,518	\$ 6,302

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NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 6 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Cont.)

Description of Assets	Fair value measurement at December 31, 2010 using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:			
Government bonds	\$ 824	\$ -	\$ -
ARS and CDOs	-	-	7,179
Foreign currency option contracts	-	19,100	-
Cross currency interest rate swap	-	20,377	-
Liabilities			
Foreign currency derivative contracts	-	(8,219)	(51)
Total	<u>\$ 824</u>	<u>\$ 31,258</u>	<u>\$ 7,128</u>

The following table presents our assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) at June 30, 2011 (unaudited):

	Level 3
Balance, at December 31, 2010	\$ 7,128
Net change in fair value included in other comprehensive income	(306)
Other-than-temporary impairment recognized in earnings	(520)
Balance, at June 30, 2011	<u>\$ 6,302</u>

For ARS and CDO debt securities, their fair value was determined using an independent third party valuator. The fair value was based on a trinomial discount model employing assumptions that market participants would use in their estimates of fair value. The assumptions included among others, the following: the underlying structure of the security, the financial standing of the issuer, stated maturities, estimates of the probability of the issue being called at par prior to final maturity, estimates of the probability of defaults and recoveries, auctions failure and successful auction or repurchase at par for each period, expected changes in interest rates paid on the securities, interest rates paid on similar instruments, and an estimated illiquidity discount due to extended redemption periods. Finally, the present value of the future principal and interest payments was discounted at rates considered to reflect current market conditions for each security.

Note 7 - DERIVATIVE FINANCIAL INSTRUMENTS

Cash Flow Hedges – The Company use currency hedging contracts (forwards and options strategies) to limit exposure to changes in foreign currency exchange rates associated with revenue denominated in a foreign currency, primarily GBP and Euro. The Company also uses currency hedging contracts to hedge against anticipated costs to be incurred in a foreign currency, primarily NIS, and to limit its exposure to exchange rate fluctuations related to payroll expenses incurred in NIS. The net gain (loss) on the effective portion of a cash flow hedge is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into revenues or operating expenses, as applicable, when the hedged exposure affects revenues or operating expenses, or as financial expenses, if the hedged transaction becomes probable of not occurring. Any gain after a hedge is re-designated because the hedged transaction is no longer probable of occurring or related to an ineffective portion of a hedge is recognized immediately as financial expenses.

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

U. S. dollars (In thousands)

Note 7 - DERIVATIVE FINANCIAL INSTRUMENTS (Cont.)

Fair Value Hedges – Cross currency interest rate swaps under which the Company agrees to pay variable rates of interest are designated as fair value hedges of fixed-rate Senior A Notes denominated in NIS (see also Note 4(1)).

Derivative Instruments Not Designated has Hedges – The Company also uses certain derivative instruments, primarily foreign currency forward contracts and options, for risk management purposes but without electing any form of hedge accounting. Any gain or loss derived from such instruments is recognized immediately as financial income or expense.

A. Derivative financial instruments are presented as other assets or other payables. For asset derivatives and liability derivatives, respectively, the fair value of the Company's outstanding derivative instruments as of June 30, 2011 and December 31, 2010 is summarized below:

	Asset Derivatives (*)		Liability Derivatives (**)	
	June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010
Derivatives designated as hedging instruments				
Foreign exchange contracts (cash flow hedge)	\$ 15,377	\$ 16,897	\$ 7,959	\$ 5,509
Cross-currency interest rate swaps (fair value hedge)	23,862	20,377	-	-
	<u>\$ 39,239</u>	<u>\$ 37,274</u>	<u>\$ 7,959</u>	<u>\$ 5,509</u>
Derivatives not designated as hedging instruments				
Foreign exchange contracts	8,902	2,044	6,664	2,710
Options exchange contracts	172	159	-	51
	<u>\$ 9,074</u>	<u>\$ 2,203</u>	<u>\$ 6,664</u>	<u>\$ 2,761</u>

(*) Presented as part of other assets

(**) Presented as part of other payables

B. The effect of derivative instruments on cash flow hedging and the relationship between income and other comprehensive income as of June 30, 2011 and December 31, 2010, is summarized below:

	Net Gain (Loss) Recognized in Other Comprehensive Income on Effective- Portion of Derivative, net		Net Gain (Loss) on Effective Portion of Derivative Reclassified from Accumulated Other Comprehensive Income (*)		Ineffective Portion of Net Gain (Loss) of Derivative and Amount Excluded from Effectiveness Testing Recognized in Income (**)	
	June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010
Derivatives designated as hedging instruments						
Foreign exchange contracts	\$ 3,256	\$ 20,002	\$ 9,567	\$ -	\$ (171)	\$ -
Others	-	-	-	10,115	-	2,034
	<u>\$ 3,256</u>	<u>\$ 20,002</u>	<u>\$ 9,567</u>	<u>\$ 10,115</u>	<u>\$ (171)</u>	<u>\$ 2,034</u>
Derivatives not designated as hedging instruments						
Foreign exchange contracts	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (4,253)</u>	<u>\$ 751</u>

(*) Presented as part of revenues/cost of sales

(**) Presented as part of financial expenses

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

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U. S. dollars (In thousands)

Note 8 - COMMITMENTS AND CONTINGENT LIABILITIES

A. LEGAL CLAIMS

- (1) On April 8, 2011, the Company filed a claim against the Government of Georgia (the "Government") in the High Court of Justice of the United Kingdom, in an amount of approximately \$100,000. The claim was filed as a result of the Government's failure to pay amounts due to the Company in connection with deliverable items under several contracts signed in 2007. Defense pleadings are anticipated to be filed in September 2011.
- (2) In December 2009, a claim in the amount of approximately \$10,000 was filed in the District Court – Central District of Israel by Pinpoint Advance Corporation ("Pinpoint") and four of its founders against two of the Company's Israeli subsidiaries, Elbit Systems Holdings (1997) Ltd. and Kinetics Ltd. ("Kinetics"), as well as against one of the Company's officers, Jacob Gadot. Pinpoint is a special purpose acquisition company that was in negotiations with the Company and other Kinetics' shareholders regarding the sale of shares in Kinetics during 2008. The transaction was not completed and negotiations were terminated. Pinpoint claims that the agreement was completed and thus entered into effect. Alternatively, Pinpoint claims that the decision not to complete the agreement was made in bad faith, and that under the circumstances Pinpoint and its founders are entitled to pecuniary compensation equal to their rights and entitlements under the alleged breached contract. The Company believes there is no merit to the allegations made in the claim, and the plaintiffs have responded accordingly to the Court. In March 2010, the Court requested the parties to attempt mediation, and a mediation process was not successful. The Court has scheduled a hearing for October 2011.
- (3) In May 2009, the Company filed a claim in the U.S. District Court for the Southern District of Illinois against Credit Suisse Group ("CSG"). The complaint seeks to recover approximately \$16,000 that the Company believes was fraudulently obtained by CSG and by its subsidiary Credit Suisse Securities (USA) from Tadiran Communications Ltd. ("Tadiran Communications") in 2007 in connection with auction rate securities purchased by Tadiran Communications through CSG. In 2008, Tadiran Communication was merged into the Company, and Tadiran Communications' activities are currently performed as part of the Company's wholly-owned Israeli subsidiary, Elbit Systems Land and C4I Ltd. CSG filed a motion to dismiss the claim based on a release signed by Tadiran Communications in 2007. In December 2009, the case was moved to the Federal Southern District of New York. In July 2010, the Court ordered the parties to continue discovery regarding the release and ruled that the meaning and scope of the release will be decided in a hearing on summary judgment rather than on a motion to dismiss.
- (4) Between 2007 and January 2010, various claims were filed in the U.S. District Court for the Southern District of New York (the "Federal SDNY") and the Supreme Court of the State of New York, County of New York ("New York State Court") by certain minority security holders of ImageSat International N.V. ("ImageSat") against ImageSat, Israel Aerospace Industries Ltd. ("IAI"), the Company, Elbit Systems Electro-Optics – Elop Ltd. ("Elop") and certain current and former officers and directors of ImageSat. The former directors include, among others, Michael Federmann, Joseph Ackerman and Joseph Gaspar (currently the Company's Board Chairman, Chief Executive Officer and Chief Financial Officer, respectively), who at various times in the past served as Elop's nominee to ImageSat's board of directors. ImageSat's largest shareholder is IAI, holding approximately 46% of ImageSat's issued share capital. Elop holds approximately 14% (7% on a fully diluted basis) of ImageSat's issued share capital and is entitled to nominate one director to ImageSat's board. The claims contained various allegations that the defendants breached their fiduciary and/or contractual obligations to the detriment of the plaintiffs. The claims alleged various causes of action and damages aggregating hundreds of millions of dollars,

ELBIT SYSTEMS LTD. AND ITS SUBSIDIARIES

NOTES TO THE CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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Note 8 - COMMITMENTS AND CONTINGENT LIABILITIES

A. LEGAL CLAIMS

not all of which were alleged against the Company, Elop and/or each of the individual defendants. Currently, all of the above-mentioned claims have been dismissed by the Federal SDNY and the New York State Court (and applicable appellate courts) on the grounds of forum non-conveniens, except for two remaining proceedings in the New York State Court by certain of the plaintiffs, claiming a breach of the Security Holders Agreement between various security holders of ImageSat, including Elop, based on an alleged failure to appoint independent directors to the ImageSat board of directors. The Company and Elop believe such claims are baseless and have filed corresponding responses to the Court.

In April 2010, the Company and Elop were served with an Application to Approve a Derivative Action (the "Application") filed in the District Court of Petach Tikva, Israel, by certain minority shareholders of ImageSat. The Application named a number of respondents, including among others, ImageSat, IAI, Elop, the Company and several former directors of ImageSat, including, among others, Michael Federmann, Joseph Ackerman and Joseph Gaspar (the Company, Elop and the above-named former directors are referred to as the "Elbit Defendants"). The Application requested the Court to approve the filing of a derivative action on behalf of ImageSat for alleged breaches by some of the respondents of the applicants' rights as minority shareholders in ImageSat. The nature of the allegations was substantially similar to those previously made by the applicants in various claims referred to above, made in the Federal SDNY and the New York State Court. The Elbit Defendants believe that there is no merit to the allegations made against them in this claim, and in July 2010, they filed motions to dismiss the Application on various grounds relating both to Netherland Antilles and Israeli law. In May 2011, the Court granted the motions to dismiss the Application, and in June 2011 the applicants filed a notice of appeal to the Supreme Court of Israel.

IAI has agreed to indemnify the Company, Elop and the directors nominated by Elop to ImageSat's board, for any losses arising out of any of the foregoing claims or legal proceedings, net of insurance proceeds received from ImageSat's insurance policies and any indemnification proceeds received from ImageSat.

- (5) The Company is involved in other legal proceedings from time to time. Based on the advice of legal counsel, management believes such current proceedings will not have a material adverse effect on the Company's financial position or results of operations.

B. COVENANTS

In connection with bank credits and loans, including performance guarantees issued by banks and bank guarantees in order to secure certain advances from customers, the Company and certain subsidiaries are obligated to meet certain financial covenants. Such covenants include requirements for shareholders' equity, current ratio, operating profit margin, tangible net worth, EBITDA, interest coverage ratio and total leverage. As of June 30, 2011, Elbit Systems and its subsidiaries were in full compliance with all covenants.

Note 9 - SUBSEQUENT EVENTS

On July 31, 2011, the Company announced that ITL ceased to be a publicly traded company.

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