

## **SHREM, FUDIM, KELNER AND COMPANY LTD.**

### **REPORT OF THE BOARD OF DIRECTORS AS AT SEPTEMBER 30, 2004**

In accordance with the Securities Regulations (Periodic and Immediate Reports) – 1970, the Board of Directors is pleased to present herewith to the shareholders its report and the financial statements of Shrem, Fudim, Kelner & Company Ltd. (hereinafter – “the Company”) for the nine-month and three-month periods ended September 30, 2004 (“the period of the report” and “the quarter”, respectively). The Company and its subsidiaries will hereinafter be called the Group.

#### **1. The Company and its Business Environment**

The Company is an investment company with holdings mainly in the capital market, industry, communications and technology, real estate and infrastructures, and commerce and services.

The Company, directly and through its investee companies, engages in purchasing, incorporating, advancing and developing activities and companies in the aforementioned segments. The Company and its subsidiaries (“the Group”) wish to advance and develop their existing investments while continuing to implement the business strategy they adopted, at the center of which is a business and organizational focus plan along with the expansion of the Group’s overseas activities (mainly in the United States and Europe). This strategy is intended to match the Group’s business structure to the business environment in Israel and abroad.

This plan is mainly reflected in Polar Investments Ltd. (hereinafter – “Polar Investments”), which is engaged in the fields of communications and technology, real estate and infrastructures, and commerce and services. The fruits of the aforementioned plan are reflected in the profitability of the period of the report and the third quarter as described below. The Group is concentrating on finding business opportunities in which it can exploit the know-how and experience accumulated by its management in a manner that will maximize their value.

The independent activities of the Company and Leader of providing consultancy, underwriting, brokerage and issuance administration services are affected by the situation of the capital markets in Israel and abroad as described below.

The Company concluded the period of the report and the quarter with income of NIS 39.1 million and NIS 10.3 million, respectively, compared with a loss of NIS 24.2 million and NIS 7.2 million in the corresponding periods last year, respectively.

During the period of the report and up to the date of its issuance, Polar Investments continued to sell marketable shares on the stock exchange, mainly of technology companies, for an aggregate consideration of NIS 183 million and a gain of NIS 64 million.

During the period of the report and up to the date of its publication, the Company, Leader, Technologies and the private companies they control, sold shares and options in publicly traded companies (mainly of Leader, Technologies, Urdan, Polar Investments, DS Securities and Opti Canada) for an aggregate consideration of NIS 110 million and a gain of NIS 25 million.

The market value (proximate to the publication date of this report) of Polar Investments’ current holdings in listed shares of principal investee and other companies such as, Nipson (described below), Nice, Mind, Arel Communications, Partner, Mivnei Ta’asiya and others, amounts to NIS 545 million and reflects an excess value of NIS 267 million compared to the value of these holdings as recorded in its books at the end of the period of the report.

The Group intends to continue the trend of selling and refreshing its investment portfolio, mainly with respect to marketable investments, while continuing to float surplus value, significantly decreasing current credit and improving the capital structure.

In April 2004, Leader and Polar Investments sold their entire holdings in Opti Canada on the Canadian exchange for amounts of NIS 7 million and NIS 45 million, respectively, and they realized pre-tax capital gains that were included in the financial statements for the second quarter of 2004, in the amounts of NIS 5 million and NIS 31 million, respectively.

In July 2004, Nipson completed an issuance of its shares on the stock exchange in London (AIM), in the aggregate amount of \$18.4 million (\$15.8 million net) including \$3.7 million from a subsidiary (indirect) of Koonras Technologies Ltd. (hereinafter – “Koonras Technologies”). Accordingly, the financial statements of Polar Investments for the third quarter of 2004 included a gain from issuance to a third party in the amount of NIS 30 million (portion of Polar Investments).

In May 2004 Polar Investments completed the sale of all its equity and control in Koonras Technologies to Polar Communications, and in doing so the communications and technology operations of the Group were merged in the framework of Polar Communications and a diversified investment portfolio of a critical volume was created in these areas.

In the period of the report and until the date of its publication most of Polar Communications' holdings in Transcel was sold for the price of NIS 46.1 million and a capital gain (pre-tax) of NIS 13.8 million, of which NIS 8.3 million will be included in the financial statements for the fourth quarter, as described below.

Proximate to the date of publishing this report Polar Communications has sold shares of Mind on and off the stock exchange for the price of NIS 38.7 million. In the fourth quarter Polar Communications will record a gain of NIS 23.7 million on the aforementioned sale.

## **2. Financial Position, Sources of Financing and Liquidity**

The Company's shareholders' equity as at September 30, 2004 totaled approximately NIS 211.9 million, which constituted 51% of the total balance sheet of the Company and private companies it controls. The shareholders' equity as at December 31, 2003 totaled NIS 166.8 million, which constituted 44% of the total balance.

The increase in the Company's shareholders' equity in the period of the report derived mainly from the Company's income in the amount of NIS 39.1 million, conversion of debentures into Company shares in the amount of NIS 3.3 million, and sale of Company shares that were held by it and by a subsidiary for a consideration of NIS 1.9 million.

As at balance sheet date, the financial liabilities (long and short-term) of the Company and private companies it controls to banks, to others and in respect of debentures less liquid resources totaled NIS 119 million, about the same as at December 31, 2003.

Presented below is data from the consolidated balance sheet and the balance sheet of the Company and private companies it controls (\*) (in millions of reported shekels of September 2004):

	As at September 30, 2004			As at December 31, 2003
	Consolidated balance sheet	Company balance Sheet	Balance sheet of Company and private companies it controls (*)	Balance sheet of Company and private companies it controls (*)
Current assets	1,518.9	90.8	83.3	99.0
Investments in companies and loans to investee (affiliated) and other companies	1,009.8	307.3	303.9	249.2
Real estate	513.9	-	-	-
Fixed assets	711.6	25.0	26.4	26.9
Other assets and deferred expenses, net	125.5	-	1.4	1.8
<b>Total assets</b>	<b>3,879.7</b>	<b>423.1</b>	<b>415.0</b>	<b>376.9</b>
Current liabilities	1,555.0	138.9	129.8	116.7
Long-term liabilities	1,612.2	72.3	72.5	93.1
Minority interest	487.1	-	0.8	0.3
Receipts on account of options issued by subsidiaries	13.5	-	-	-
Shareholders' equity	211.9	211.9	211.9	168.8
<b>Total liabilities and shareholders' equity</b>	<b>3,879.7</b>	<b>423.1</b>	<b>415.0</b>	<b>376.9</b>

(\*) In this report, "the Company and private companies it controls" refers to the consolidated balance sheet which includes the publicly traded subsidiaries controlled by the Company (Leader and Shrem Fudim Kelner Technologies Ltd. (Technologies)), on the equity basis.

The main changes in the assets and liabilities of the Company and private companies it controls are described below:

- The current assets totaled NIS 83.3 million as at September 30, 2004, compared with NIS 99.0 million at the end of 2003. The decrease in current assets derives mainly from the decrease in the scope of the marketable securities portfolio.
- Investments in and loans to investee and other companies totaled NIS 303.9 million as at the end of September 2004, compared with an amount of NIS 249.2 million at the end of December 2003. The increase derived from the share of the Company in income of investee companies (mainly Leader, Technologies and Dirad Investments Ltd. ("Dirad") – see Section 4.12 below) in an amount of NIS 44.0 million and the increase in the Company's investment in Leader.

During the period of the report, the Company converted debentures and exercised option warrants of Leader in a net amount of NIS 27 million (and sold shares of Leader for NIS 18.6 million) – see Section 5.2 below).

### 3. Operating Results

#### General

As mentioned above, the improvement in the capital markets, the efficiency measures taken and the focusing of the Group's business strategy all contributed to the improvement in the Group's operating results.

The Company and private companies its controls are showing total revenues from consulting, management and participation in the profits of funds in the period of the report of NIS 23.8 million (compared with NIS 11.2 million in the corresponding period last year) and total revenues as stated in the quarter of NIS 3.9 million (compared with NIS 3.1 million in the corresponding quarter last year).

The increase as stated in the total revenues is the result of commencement of managing the Sphere Fund, an increase in the scope of the Group's investment banking activities, and particularly consulting with respect to project financing in connection with projects overseas (see Sections 4.10 and 4.11, below).

Commencing in the period of the report, the Company implements Accounting Standard No. 12 which deals with discontinuance of the adjustment of financial statements. Therefore, the adjustment was discontinued as at January 1, 2004 (see also Note 1D of the financial statements), a fact that affects the scope of the Company's financing expenses.

The Company ended the period of the report with income of NIS 39.1 million, compared with a loss of NIS 24.2 million in the corresponding period last year. The income for the quarter was NIS 10.3 million, compared with a loss of NIS 7.2 million in the corresponding quarter last year. The increase in income during the period of the report derives mainly from the increase in revenues as described above and from the share of the Company in the results of investees (mainly Leader, Technologies and Dirad).

**Set forth below is data from the income statements of the Company and the private companies it controls, in millions of reported shekels of September 2004:**

	<b>Nine Months 2004</b>	<b>Nine Months 2003</b>	<b>Quarter 3 2004</b>	<b>Quarter 3 2003</b>
<b>The Company and private companies it controls (*)</b>				
Revenues from consulting, management and participation in profits of funds	23.8	11.2	3.9	3.1
Income (loss) from long-term investments, net	0.1	1.0	(0.2)	0.3
Gain on marketable securities, net	7.3	24.4	1.3	7.5
Total other costs and expenses	(24.6)	(27.3)	(4.8)	(8.8)
Income before financing expenses, net	6.6	9.3	0.2	2.1
Financing expenses, net	(8.7)	(10.7)	(2.8)	(4.4)
Taxes on income	(0.3)	(2.2)	(0.2)	(0.5)
Company's equity in results of investee companies	44.0	(21.1)	13.1	(4.3)
Minority share in results of subsidiaries, net	(2.5)	0.5	-	(0.1)
<b>Income (loss) for the period</b>	<b>39.1</b>	<b>(24.2)</b>	<b>10.3</b>	<b>(7.2)</b>

(\*) Data of the Company and the private companies it controls – means the consolidated statement of income in which the public subsidiaries directly held by the Company are included on the equity basis (Leader and Technologies).

**The operating results of the Company and the private companies it controls for the period of the report are explained as follows:**

- In the period of the report, the Company presents gains from marketable securities of only NIS 7.3 million, compared with NIS 24.4 million in the corresponding period of 2003, this being due to the weakening of the capital markets in the second and third quarters of the year.
- The share of the Company in the income of investee companies during the period of the report and the quarter amounted to NIS 44.0 million and NIS 13.1 million, respectively, and derived mainly from its share in the income of Leader, Technologies and Dirad (in the corresponding periods last year – losses of NIS 21.1 million and NIS 4.3 million, respectively).
- The total other costs and expenses amounted to NIS 24.6 million in the period of the report, compared with NIS 27.3 million in the corresponding period of 2003 (NIS 4.8 million in the quarter compared with NIS 8.8 million in the corresponding quarter of last year). The net decrease in costs in the period of the report and in the quarter derived mainly from canceling provisions that were recorded in prior periods to cover exposures in respect of legal claims and other risks, subsequent to a verdict being handed down in favor of the Company (see Section 5.1 below), even though there was an increase in the provision for bonuses to managers and employees as a result of the performance of the Company and its private investee companies.
- The financing expenses of the Company and private companies it controls amounted to NIS 8.7 million in the period of the report (NIS 2.8 million in the quarter), compared with NIS 10.7 million in the corresponding period last year (NIS 4.4 million in the corresponding quarter last year). The decrease in the financing expenses derives from the decline in the scope of the Company's liabilities to banks, regardless of the negative effect of discontinuing the adjustment of the financial statements to the effect of inflation.

#### **4. Holdings and Investments**

##### **4.1 Leader Holdings & Investments Ltd. ("Leader")**

Leader is a holding company whose major holdings are Polar Investments, Urdan and BSR Europe. It also engages directly and indirectly in rendering management, underwriting, and consulting services, handling securities issuances for entities interested in raising funds, and making non-banking investments in various sectors of the Israeli economy.

Leader's shareholders' equity amounted to NIS 267.0 million as at September 30, 2004, compared with NIS 185.7 million as at December 31, 2003. The increase in Leader's shareholders' equity is a result of the income for the period of the report in an amount of NIS 50.5 million and the conversion of debentures and exercise of options held by the Company and others. See Section 5.2 below.

During the period of the report the financial liabilities (long and short-term) of Leader and the private companies it controls (according to a consolidated balance sheet which includes the public subsidiaries held directly by Leader on the equity basis) to banks, to others and in respect of debentures less its liquid resources, declined by NIS 82 million compared with December 31, 2003, and as at September 30, 2004 they total NIS 128 million.

The improvement in the liquidity of Leader is reflected, inter alia, in an increase in the assets of Leader and the public companies under its control by the amount of NIS 47 million as at September 30, 2004 (NIS 559 million compared with NIS 512 million as at the end of December 2003).

Leader concluded the period of the report with net income of NIS 50.5 million compared with a loss of NIS 44.2 million in the corresponding period of last year (net income of NIS 10.5 million in the quarter compared with a loss of NIS 13.9 million in the corresponding quarter of last year).

As at September 30, 2004, the net asset value of the investment in Leader on the Company's books amounted to approximately NIS 190 million. As a result of the sale of shares, conversion of debentures and exercise of options during the period of the report, the Company effectively holds 67.5% of Leader's share capital.

## **4.2 Capital Market Activity**

### **4.2.1 Issuances, distribution of securities and brokerage**

Operations in the capital market during the period of the report continued to reflect the recovery which began at the end of 2003. This recovery is visible in the business results of the Leader Group, mainly in the scope of revenues from consulting, underwriting, brokerage, and issuance management services. In the period of the report and in the quarter, these revenues totaled NIS 34.0 million and NIS 9.5 million, respectively, compared with NIS 13.7 million and NIS 3.5 million, respectively, in the corresponding periods last year. There has been a recent decline in the trend described above which affects, inter alia, the scope of the fundraisings executed on the primary market.

In the period of the report the Leader Group, through the companies Leader Issuances and Leader & Co., was involved in more than 40 public and private issuances as well as the distribution of securities, of which 17 were public issuances, and Leader Issuances served in most of them as the head manager of the underwriting consortium.

In the period of the report, the Ma'of index increased by 4.2% in real terms, after a decrease of 5.1% in the third quarter of 2004. In 2003 the Ma'of index increased in real terms by 53%.

### **4.2.2 DS Securities and Investments Ltd. ("DS Securities")**

DS Securities engages primarily in providing advisory services and management of the stock investment portfolios of its clients, as well as in the management of mutual funds, provident funds and continuing education funds. DS Securities is a member of the Tel-Aviv Stock Exchange (hereinafter – "the Stock Exchange").

Subsequent to balance sheet date the Company entered into an agreement by which it sold 442,000 ordinary shares of DS Securities, in an off-floor transaction, for the price of NIS 14.75 per share and a total cash consideration of NIS 6.5 million. It was further agreed on a number of changes in the contract that was signed between the buyer and the Company (and other parties) on May 26, 2003 (hereinafter – the sale agreement). Most of the changes in the sale agreement were that a put option that had been granted to the Company by the buyer would apply to the remaining 758,000 shares of the Company in DS Securities (hereinafter – the option shares) at the price of NIS 15.7 per option share and for a total cash consideration of NIS 11.9 million. The put option will be exercisable only once in respect of all the option shares during a period of 14 days beginning from January 1, 2005. The buyer undertook that with respect to the option shares, it would be subject to the provisions of Section 103 of the Income Tax Ordinance. Furthermore, it was agreed that if and when the put option is exercised, certain commitments that the Company and Leader made to the buyer in the sale agreement would be cancelled, including non-competition.

The Company anticipates a pre-tax gain in the amount of NIS 3 million in respect of the sale of the shares, which will be included in the annual financial statements of the Company for 2004. The pre-tax gain anticipated by the Company in respect of the shares that will be sold upon the exercise of the put option, if exercised, is NIS 6 million.

Upon the closing of the aforementioned transaction the Company's holding in the share capital of DS Securities decreased to 10%

### **4.3 Urdan Industries Ltd. ("Urdan")**

#### **4.3.1 Areas of activity of Urdan**

Urdan is a public company, the shares of which are traded on the Stock Exchange. It has direct and indirect holdings in a wide variety of industrial companies, and is also directly engaged in industrial activities.

During the period of the report Leader and one of its wholly-owned subsidiaries sold shares and options of Urdan, for an amount of NIS 29 million at a pre-tax gain of NIS 10 million.

Due the aforementioned sales, as at the balance sheet date Leader holds, directly and indirectly, 60.49% of the share capital of Urdan. As at September 30, 2004, the investment in Urdan is recorded on the books of Leader and its wholly-owned subsidiary at the amount of NIS 109 million (including debentures in the amount of NIS 14 million).

Urdan finished the period of the report with net income of NIS 3.2 million, compared with a loss of NIS 21.3 million in the corresponding period of last year (net income of NIS 1.0 million in the quarter, compared with a loss of NIS 9.7 million in the corresponding quarter of last year).

In the period of the report the sales of Urdan and its subsidiaries amounted to NIS 588.1 million, compared with NIS 565.2 million in the corresponding period of last year. The sales in the third quarter of 2004 amounted to NIS 211.1 million, compared with NIS 201.4 million in the corresponding quarter of last year. The increase in sales in the period of the report mainly derives from the activity of Orlite Industries (Millennium 2000) Ltd. ("Orlite Millemmium"), principally in respect of sales to the civilian market, and from the business of Univerkol, Hillel, Hoffman & Sons ("Univerkol") following its success in penetrating new markets, in addition to its traditional activities and the increase in the variety of its products.

**Urdan has holdings in a large number of companies, the most prominent of which are described below:**

#### **4.3.2 Orlite Industries (1959) Ltd. ("Orlite")**

Orlite, a wholly owned subsidiary of Urdan, is a holding and investment company specializing in investments in the area of industry.

Orlite's net income for the period of the report amounted to NIS 2.5 million, compared with a loss of NIS 18.5 million in the corresponding period of last year. Orlite finished the third quarter of 2004 with net income of NIS 1.0 million, compared with a loss of NIS 11.5 million in the corresponding quarter last year. The improvement in Orlite's financial results in the period of the report derives mainly from an increase in sales, from the increase in the gross profit margin due to efficiency measures, and from a decrease in the financing expenses.

Proximate to the date of publishing the financial statements Orlite Millennium signed an agreement with the Defense Ministry, in effect until the end of 2007, by which Orlite Millennium will supply equipment to the Defense Ministry for a total consideration of NIS 52 million. Under certain circumstances, it is possible that the agreement will be extended by two additional years without any change in the total consideration.

Ytong, the shares of which are traded on the Stock Exchange (held 84.5% by Urdan and Orlite), is engaged, both directly and through companies it owns, in the manufacture of a variety of products, building blocks, ready-made plaster, ready-made powder for use, insulation materials, glues and additives for building materials. Ytong is the controlling shareholder of, among other companies, Aloni Enterprises Ltd.

Ytong operates through, among others, Aloni (a company in which Ytong Industries holds directly and indirectly 87.8% of the share capital), in the production and marketing of flooring stone and Terrazzo stairs, import, processing and marketing of natural marble, processed marble and granite, import and marketing of ceramics, sanitary utensils, parquet and polishing and shining materials for the marble and flooring stone industry. Regarding class and other actions filed against Aloni and others, there was no change in the description presented in the Company's financial statements as at December 31, 2003.

In addition, Ytong operates through Univerkol, Hillel, Hoffman & Sons (Ytong indirectly holds 55.9% of Univerkol's share capital), a public company whose shares are traded on the Stock Exchange, which is engaged in the manufacture and marketing of a wide range of paints for various uses, as well as insulation materials, plaster products, polish products, industrial protective coatings and performance of projects. Regarding the claim filed in the United States against Univerkol and its subsidiary, see Note 3D(3) of the financial statements.

Ytong Industries concluded the period of the report with net income of NIS 4.0 million, compared with net income of NIS 2.4 million in the corresponding period last year. Ytong Industries' net income in the third quarter of 2004 amounted to NIS 1.5 million, compared with net income of NIS 4.6 million in the corresponding quarter last year.

#### **4.3.3 Other Holdings of Urdan**

As at balance sheet date, the Company, Technologies and Urdan effectively hold 9.2%, 3.3%, and 21.5%, respectively, of the capital and control in a venture for application of advanced technologies for dealing with disposal of solid municipal waste ("EER"). In addition, a limited partnership of private investors managed by a subsidiary holds an additional 4.4%, and an additional 1.2% is held by other funds managed by the Company.

As at balance sheet date, the cost of the investments of the Company, Technologies, and Urdan in EER, mainly through shareholders' loans (before the share of the companies in the losses of the venture) was NIS 12.1 million, NIS 4.5, and NIS 28.4 million, respectively (out of total investments of NIS 95.8 million that were made by the various shareholders).

In March 2004 EER signed a number of agreements with Mr. Mokoto Takahashi ("the Japanese Investor") by which the Japanese Investor will invest in EER (directly or through companies under his control) the amount of US\$ 5 million in consideration of 10% of the share capital of EER (according to a company value after the investment of \$ 50 million). In accordance with the aforementioned agreements, the Japanese Investor transferred the amount of the investment to EER.

As a result of the transaction a deferred gain in the amount of NIS 4.8 million and NIS 9.1 million was created for the Company and Urdan, respectively, of which the Company and Urdan recognized in the statement of income NIS 1.2 million and NIS 2.3 million, respectively, in the period of the report, in accordance with Opinion 68 of the Institute of Certified Public Accountants in Israel. The rest of the gain will be recognized in equal portions over a period of three years or up to the amount of the Company's and Urdan's share in the losses of EER, whichever higher on a cumulative basis.

Concurrent with the signing of the agreements, a subsidiary was set up in Japan ("the Japanese Company"), owned jointly by EER and companies under the control of the Japanese Investor. According to a licensing agreement signed between EER and the Japanese Company, the Japanese Company will be the owner of an exclusive license to use EER's know-how with respect to certain matters in Japan for periods as stipulated in the licensing agreement.

On June 27, 2004, EER signed an in-principle agreement to cooperate with the Ukrainian Government, the Korchtov Institute and the Radon Institute, for purposes of constructing a number of facilities in Chernobyl for removal of low-radiation radioactive waste (hereinafter – "the Project"). The Project is to be executed based on the BOT method, where EER will be responsible for construction, operation and delivery of the facilities. EER intends to bring in international financing institutions for purposes of financing the Project.

On November 7, 2004, EER signed an agreement with the Japanese Investor with respect to an additional investment in EER. Pursuant to the agreement, the Japanese Investor will invest an additional US\$ 4 million for another 5.1% of EER's share capital (based on a value of the company after the investment of \$79 million), of which the Japanese Investor has invested \$ 2 million on account of the aforementioned investment. In addition, the Japanese Investor was given an option to invest another \$1 million until the end of 2004, based on the same company value, in consideration of 1.25% of EER's share capital. After execution of the investment, the Company, Technologies and Urdan will hold 8.7%, 3.2% and 20.4%, respectively, in EER's share capital and the Company and Urdan will have an additional deferred gain of NIS 2 million and NIS 3 million, respectively, which will be recognized in the statement of income in a manner similar to that described above. See also Note 3E of the financial statements.

#### **4.4 Polar Investments Ltd. ("Polar Investments")**

##### **4.4.1 Areas of Activity of Polar Investments**

Polar Investments, a public company whose shares are traded on the Stock Exchange, invests and manages investments in various sectors: communications and media, technology and software, real estate and infrastructures, commerce, services, financing, and others.

As at balance sheet date Leader effectively held 47% of the share capital of Polar Investments and 50% of the voting rights therein, after having sold part of its holdings in Polar Investments in the period of the report for the price of NIS 30 million. The net asset value of the investment of Leader in Polar Investments on the books of Leader is NIS 181 million.

Polar Investments reported income of NIS 41.7 million in the period of the report, compared with a loss of NIS 47.6 million during the corresponding period last year (income of NIS 15.0 million in the quarter, compared with a loss of NIS 9.6 million during the corresponding quarter last year). The increase in income was a result of the recovery of the markets, the reduction in total liabilities, the efficiency measures taken, and the focusing of its business strategy.

**Polar Investments has holdings in a large number of companies, the most prominent of which are described below:**

#### **4.4.2 Communications, Digital Printing Systems, Media, Technology and Software**

##### **4.4.2.1 Polar Communications Ltd. (“Polar Communications”)**

Polar Communications is a public company, the shares of which are traded on the Stock Exchange, and which invests and manages investments in the areas of communications, media, computer systems, and communications technology. Its major investments include: Partner (2.4%), YES (8.1%), Nipson (71.5%), Mind (4.5% - see below), Reshet (26%), Cimatron (32.7%) Arel Communications (14%), Maximedia (50%), Smartlink (14.8%), etc.

Pursuant to the approval of the General Shareholders' Meeting of Polar Communications from May 24, 2004, Polar Communications purchased from Polar Investments all of the shares of Koonras Technologies Ltd. (“Koonras”) (described below), for a consideration of NIS 79 million. In addition, out of the shareholders' loans in the amount of NIS 43.8 million that had been granted by Polar Investments to Koonras, the amount of NIS 10 million was repaid immediately after the completion of the transaction and the balance is to be repaid in six equal semi-annual installments. The aforementioned shareholders' loans include an amount of NIS 10.2 million in respect of the holdings of Polar Investments in the share capital of Ophirtech (42.5%) that were purchased by Koonras in January 2004. The consideration for the transaction was approved by Polar Communications on the basis of, among other things, a fairness opinion of an external appraiser, whereby the value of Koonras exceeds the amount of the aforementioned consideration.

In the framework of this transaction, the communications and technology areas of the Polar Investments Group were consolidated into Polar Communications thus creating a diverse investment portfolio of a critical size in these areas.

Upon completion of the transaction and in exchange for the rights of the joint chairman and CEO of Koonras to 7.5% of the share capital of Koonras (through a company he controls), the aforementioned received from Polar Investments shares of Polar Communications comprising 2.9% of the latter's share capital.

In addition, in July 2004, Polar Investments completed, pursuant to a partial tender offer it published, acquisition of additional shares of Polar Communications comprising 6.2% of the latter's share capital, for a total consideration of NIS 19.2 million. Accordingly, the holdings of Polar Investments in the share capital of Polar Communications increased to 86.7%.

Polar Communications presented net income in the period of the report of NIS 49.6 million, compared with net income of NIS 4.4 million in the corresponding period last year. Polar Communications presented net income in the quarter of NIS 20.5 million, compared with net income of NIS 0.5 million in the corresponding quarter last year.

Most of the income of Polar Communications derives from the issuance of Nipson in London in the third quarter, the sale of its holdings in Pointer in the second quarter and the sale of marketable shares, mainly in Mind and Arel Communications, as described below.

### **Partner Communications Ltd. (“Partner”)**

Polar Communications owns a 2.4% share of Partner, a company which operates a mobile telephone network in Israel using the GSM method. Partner operates under license from the Israeli Ministry of Communications.

The stock market value of the investment of Polar Communications in Partner proximate to the date of signing the financial statements amounted to NIS 138 million and largely reflects an excess over the book value of the investment on the books of Polar Communications.

Further to the Ministry of Communications’ announcement regarding regulatory changes, including a reduction in various rates of communications, Partner reported on November 18, 2004 that the aforementioned changes still have a material adverse effect on its profits and financial position, although less than it had reported in its previous notice on the matter in July 2004.

Since Polar Communications presents its investment in Partner as a permanent investment on the cost basis, the results of Partner do not themselves affect the financial statements of Polar Communications.

### **D.B.S. Satellite Services (1998) Ltd. (“D.B.S.”or “YES”)**

D.B.S. operates multi-channel television broadcasting via satellite pursuant to a license granted to it by the Ministry of Communications. The services provided by YES include multi-channel television pay broadcasts to subscribers, audio and information services and other interactive services. The services are transmitted via satellite using digital technology. The rate of holdings of Polar Communications in the share capital of Yes is 8.13% (7% taking into account the exercise of option warrants allotted in April 2004 to the shareholders of YES, including Polar Communications).

In the period of the report and the third quarter, YES presented revenues of NIS 754.5 million and NIS 268.7 million, respectively, compared with revenues of NIS 614.8 million and NIS 216.5 million, respectively, in the corresponding periods last year.

Primarily as a result of the increase in revenues, the operating losses of YES declined in the reported periods compared with the corresponding periods of last year. Accordingly, YES presented a decrease in the loss in the period of the report and the third quarter, which amounted to NIS 277.4 million and NIS 71.9 million, respectively, compared with a loss of NIS 414.8 million and NIS 131.9 million, respectively, in the corresponding periods last year.

As a result of the losses of YES, its shareholders’ deficiency and its working capital deficit as at September 30, 2004 amounted to NIS 3,106 million (including shareholders’ loans in the amount of NIS 2,552 million) and NIS 1,763 million (including short-term bank credit in the amount of NIS 1,312 million), respectively.

Since Polar Communications reports its investment in YES as a permanent investment on the cost basis, the losses of the latter do not themselves have an impact on the financial statements of Polar Communications.

As at September 30, 2004, the balance of the investment of Polar Communications in YES (mainly in shareholders' loans) on its books amounted to NIS 112.3 million.

Regarding the agreements YES reached with the banks, the valuation that was made of it and the intention of Bezeq, The Israel Telecommunications Company Ltd. to invest additional amounts in YES, see Note 3C1E to the financial statements.

The activities of YES are contingent on the continued receipt of shareholders' loans as part of the financing agreements, including loans from Bezeq in accordance with the work plan of YES as described above. YES Management estimates that the chances are good that YES will succeed in arranging the sources of finance needed by YES for the coming year.

#### **Mind C.T.I. ("Mind")**

Mind, part of whose shares are traded on the NASDAQ and on the Tel-Aviv Stock Exchange, is engaged in development and sale of software products for collections and billing and management solutions for communications networks, which are based mainly on internet protocol (IP).

In the period of the report and up to the date of its publication, Polar Communications sold most of its shares in Mind, on and off the NASDAQ, for a consideration of NIS 59.6 million and it realized a pre-tax capital gain of NIS 38.5 million, NIS 10.8 million of which was included in the financial statements of the period of the report. Due to the said sales, the rate of holdings of Polar Communications in the share capital of Mind declined from 18% to 4.5%.

#### **Reshet Communications and Productions Company (1992) Ltd. ("Reshet")**

Reshet is engaged in the operation of commercial television broadcasts on the Second Channel under a concession that was granted to it. Polar Communications holds 26% of the rights to earnings and 27% of the voting rights in Reshet.

In September 2004, after receipt of the decision of the Supervisor of Restrictive Business Practices, the Council of the Second Channel decided that the upcoming tender for television broadcasts on the Second Channel for a period of ten years (from November 1, 2005), would be awarded to only two concessionaires.

Reshet is preparing to compete in the tender, which will be submitted at the beginning of January 2005, and it is anticipated that the results will become known during March 2005.

#### **Arel Communications Ltd. ("Arel")**

Arel is engaged in the development and marketing of distance learning systems and is traded on a U.S. stock exchange. Following the sale on the stock market of part of Polar Communications' shares in Arel in the period of the report, for the amount of NIS 7.6 million and a gain of NIS 6.5 million, the percentage of Arel's share capital held by Polar Communications decreased to 14%.

The market value of Polar Communications' investment in Arel close to the signing date of the financial statements amounted to NIS 9 million and reflects an excess of NIS 5 million over the book value of the investment on the books of Polar Communications.

#### **Pointer from the Eden Telecom House Ltd. ("Pointer")**

In June 2004, the sale of the full amount of Polar Communications' holdings (20.5%) in Pointer (including assignment of the shareholders' loans and a perpetual capital note) to Nexus Telocation Systems Ltd., a company traded on a U.S. stock exchange, was completed for a consideration of 7.5% of the shares of Nexus (as at that time) and options exercisable into additional shares of Nexus. As a result of the sale, in the second quarter Polar Communications realized a pre-tax capital gain in the amount of NIS 8.5 million.

#### **4.4.2.2 Koonras Technologies Ltd. ("Koonras")**

Koonras is a wholly-owned subsidiary of Polar Investments specializing in investments in advanced technology and biochemical companies. The principal investments of Koonras include: Nipson (70%), Cimatron (32.7%), Smartlink (14.8%), and others. See also Note 3C(1)(A) of the financial statements.

As noted above, Polar Communications completed acquisition of the full ownership and control of Koonras from Polar Investments. Accordingly, as at the date of this report, the balance sheet of Koonras has been consolidated for the first time with the balance sheet of Polar Communications as at that date. The results of Koonras in the period of the report before its consolidation as aforementioned are included in the consolidated statements of income of Polar Investments for that period.

#### **Nipson Digital Printing Systems PLC ("Nipson")**

Nipson is engaged in the manufacture, development, sale and international marketing of digital printers for black and white commercial printings, at high speeds, in short or long series. The printing is accomplished by means of special technology involving magnetic embedding, which permits printing on different surfaces.

At the end of July 2004, Nipson completed issuance of its shares on the London Stock Exchange (AIM). In the framework of the aforementioned issuance, Nipson raised \$18.4 million (\$15.8 million net), including \$3.7 million from a subsidiary (indirect) of Koonras, this being based on a company value (after the money) of \$57 million.

Upon completion of the above-mentioned issuance, Koonras' rate of holding (indirect) in Nipson's share capital dropped from 94% to 70%, and the financial statements for the third quarter of 2004 include a gain from issuance to a third party in the amount of NIS 30 million (share of Polar Investments).

In May 2004, Nipson signed an agreement with certain investors for receipt of a loan in an amount of €4 million, which is to be repaid at the earlier of completion of the public issuance of Nipson, or six months from the date of its receipt. Accordingly, shortly after the issuance of Nipson, as described above, the loan was repaid.

As part of the above-mentioned agreement, Nipson granted the investors options in a quantity equal to half of their investment, as stated, for exercise during a three-year period, at an exercise price equal to 80% of the price of the public issuance of Nipson.

Nipson's loss in the period of the report amounted to NIS 12.8 million, NIS 3.6 million of which is in the third quarter, compared with a loss of NIS 3.2 million in the corresponding period last year, most of which was in the third quarter. The loss in the period of the report derives, mostly, from additional expenses in connection with the plan for a structural change and greater efficiency, which was adopted by Nipson last year, together with the increase in the operating loss, as aforementioned.

In September and October 2004 Polar Communications purchased additional shares of Nipson for the price of NIS 5 million and accordingly its holding (direct and indirect) increased to 71.5% of the share capital of Nipson.

The stock market value of the holding of Polar Communications in Nipson (71.5% directly and indirectly) proximate to the date of signing the financial statements, was NIS 205 million and reflects an excess of NIS 126 million over the amount at which the investment is presented in the books (the share of Polar Communications).

#### **4.4.2.3 Bezeq The Israel Telecommunications Company Ltd. ("Bezeq")**

In October 2004 Polar Investments and Polar Communications submitted a joint request to be invited to participate in the sale process and to make offers for purchasing the holdings of the State in Bezeq, by means of purchasing 30% of the share capital of Bezeq and an option to purchase an additional 10.66% of the share capital of Bezeq owned by the State.

Polar Investments signed a memorandum of understanding with a company from the Rothschild Bank Investment Group ("the Rothschild Bank Group") by which the Rothschild Bank Group intends to participate in the process of acquiring shares of Bezeq as aforementioned together with the Polar Group including Polar Communications.

### **4.4.3 Real Estate and Infrastructures**

#### **4.4.3.1 Polar Real Estate Ltd. ("Polar Real Estate")**

Polar Real Estate is the real estate division of the Polar Investments Group and it is engaged in the promotion and improvement of real estate and in the development, marketing and execution of residential, office and commercial projects, the rendering and marketing of time-sharing services for vacation units as well as investments in real estate in Israel and abroad. See also Note 3C(2) to the financial statements.

In the period of the report and in the third quarter, Polar Real Estate's revenues totaled NIS 173.3 million and NIS 49.8 million, respectively, compared with revenues of NIS 118.8 million and NIS 47.4 million in the corresponding periods last year, respectively. The increase in Polar Real Estate's revenues stems, mainly, from the first time recording of revenues in the second quarter from the residential project Life Park, in Herzlyia Pituah, and from completion of the sale of real estate in Tel-Aviv in the first quarter.

The improvement in the operating results of Polar Real Estate derives mainly from the gain from selling the building in Manhattan as described below, from the increase in revenues together with the increase in the gross and operating profit mainly from the residential projects Life Park in Herzliya Pituah and Holy Land in Jerusalem, as well as from a decrease in financing expenses.

Polar Real Estate reached in-principle agreements with banks regarding a rescheduling of the repayment dates of part of the bank loans it received with respect to credit that was not granted as part of project accompaniment, and, at the same time it is being financed mainly by shareholders' loans from Polar Investments. During the period of the report, Polar Investments granted additional shareholders' loans to Polar Real Estate in an amount of NIS 16.1 million. As at the balance sheet date, the balance of the shareholders' loans made by Polar Investments to Polar Real Estate amounted to NIS 168.2 million.

In August 2004, Polar Investments acquired from the Etgar Fund 8.68% of the shares of Polar Real Estate, for a consideration of \$3.2 million. Accordingly, the rate of holding of Polar Investments in the share capital of Polar Real Estate increased from 71.3% to 80.01%.

In September 2004 Polar Real Estate sold (indirectly) together with partners the lease rights in a residential building in Manhattan for the total price of \$ 51 million. Following this sale Polar Real Estate included in the financial statements for the third quarter a net capital gain in the amount of NIS 7.0 million.

Further to the expiration of agreements (in April 2004), signed in December of last year between Polar Investments, Polar Real Estate and its subsidiaries, on the one hand, and companies of the Shikun U'vinui Group, on the other, on May 24, 2004 a memorandum of agreement and understandings was signed between the parties, determining a framework for new agreements most of which were signed thereafter and which regulate certain matters as described in Note 3C(2) to the financial statements.

These agreements and transactions are interdependent. In addition, the above transactions are contingent on a number of pre-conditions (see also Note 3C(2) to the financial statements). If the above-mentioned transactions are consummated, a significant decrease is expected in the balance of Polar Real Estate's liabilities with no material impact on the statement of income.

Regarding the exposure of Polar Real Estate due to the decision of the Supreme Court sitting as the High Court of Justice to void decisions 717, 727, and 737 of the Israel Lands Administration, and the transition provisions formulated by the Israel Lands Administration regarding this matter, see Note 3C(2)(e) to the financial statements.

#### **4.4.3.2 Ophir Holdings Ltd. ("Ophir")**

Ophir is an investment and holding company and it is engaged mainly in the area of rental real estate. Ophir's main investments include: Mivnei Ta'asiya Ltd. (10.3%), Shemi Bar (22.2%), ADR House Partnership (70%), and others. The rate of Polar Investments' holdings in Ophir's share capital is 57.5%, and it is classified as a proportionately consolidated company in Polar Investments' financial statements in accordance with this percentage.

In the period of the report and in the third quarter Ophir showed net income of NIS 11.7 million and NIS 7.3 million, respectively, compared with a loss of NIS 0.2 million and net income of NIS 1.3 million in the corresponding periods last year, respectively. Most of the income reported during the period of the report derived from the receipt of a dividend from Mivnei Ta'asiya in the total amount of NIS 10.3 million, NIS 6.1 million of which in the third quarter.

During the period of the report, Ophir sold part of its shares in Mivnei Ta'asiya on the Tel-Aviv Stock Exchange for an amount of NIS 21.2 million. As a result of this sale, its share in the capital of Mivnei Ta'asiya decreased to 10.3%, and Ophir reported a capital gain of an immaterial amount in its financial statements in the period of the report.

The market value of the investment of Ophir in Mivnei Ta'asiya as at the date of the drafting of the financial statements amounted to NIS 156 million and reflects an excess of NIS 4 million over the book value of the investment.

#### **4.4.3.3 Hazera (1939) Ltd. (“Hazera”)**

Hazera is a 50% owned subsidiary of Polar Investments and it is engaged mainly in the growth of vegetable seeds, other farm seeds, and fresh vegetables, as well as handling the real estate assets it owns, including among others, the Shalem Ranch near the Mesubim intersection (Tel-Aviv) and the Mivchor Ranch near the Plugot intersection (Kiryat Gat).

During the period of the report, Hazera had sales of NIS 19.5 million and net income of NIS 0.2 million, compared with sales of NIS 15.6 million and a loss of NIS 1.6 million in the corresponding period last year, respectively.

#### **4.4.3.4 Polar Infrastructures Ltd. (“Polard Infrastructures”)**

Polar Infrastructures is a wholly-owned subsidiary of Polar Investments which specializes in investment in companies and operations in the fields of infrastructures, municipal services and water and sewage systems. Its main investments are as follows: M.G.A.R. Computerized Collection Center Ltd. (40%), City Pass Ltd. (held directly by Polar Investments) which was granted a concession to build, finance, and operate the light railway in Jerusalem (subject to the signing of a financing agreement for the project) and Aquize Smart Water Technologies Ltd. (62%).

In March 2004, Polar Investments and a third party sold in equal parts 20% of City Pass, for an amount roughly equal to the cost of their investments in City Pass to date. This agreement is subject to the receipt of various approvals, inter alia, from the authorities. Should the agreement be consummated, the rate of Polar Infrastructures' holdings in the share capital of City Pass will decrease to 27.5%.

#### 4.4.4 Trade and services

##### 4.4.4.1 Polar Trade and Services Ltd. (“Polar Trade”)

Polar Trade is a wholly-owned subsidiary of Polar Investments and it conducts most of its operations through Day Telecom Ltd. (80%; hereinafter – “Day”). Day is engaged (directly and indirectly), mainly, in the import, sale, support and marketing of end-user cellular equipment in Israel, development, marketing and operation of pre-paid systems for cellular telephones, and is active in Italy through a subsidiary in the development, manufacture, and marketing of communications transmission products and cellular telephones (hereinafter – “Day Italy”).

Polar Trade’s revenues in the period of the report and in the third quarter, amounted to NIS 254.9 million and NIS 78.1 million, respectively, compared with revenues of NIS 58.4 million and NIS 4.7 million in the corresponding periods last year, respectively. The increase in revenues derived mainly from the increase in the frequency of orders from a major customer of Day in Israel, and from consolidation of the revenues of Day Italy commencing with the period of the report.

In May 2004, Polar Investments sold 7.66% of its holdings in Polar Trade for the amount of €4.6 million, to a third party (“the Investor”) who is also a shareholder (20%) in Day. Furthermore, a shareholders’ agreement was signed in Polar Trade, in which certain arrangements were provided including the granting of an option to the Investor to sell to the company its holdings in Polar Trade and in Day for the price of €1 million (see below regarding exercise of the option). Polar Investments decided to designate most of the consideration for financing the current operating needs of Day Italy, which operations are currently in their initial stages of development.

Accordingly, in the third quarter Polar Investments invested (indirectly) the amount of €3.6 million for purposes of financing the activities of Day Italy. Concurrently, a subsidiary of Day purchased from an indirectly related party of the Investor, for an immaterial amount, a liability of Day Italy, the value of which in Day’s consolidated financial statements (“Day’s financial statements”), amounted to €13 million.

As a result of the above, the entire amount of the aforementioned liability was written off in Day’s financial statements. The write-off was posted against the entire unallocated excess of cost generated on the initial consolidation of Day Italy in Day’s financial statements as at December 31, 2003, which was deducted from the balances of non-monetary assets of Day Italy proportionately to their fair value as at December 31, 2003. The remaining balance, in the amount of NIS 14 million, was presented as negative excess cost and it will be posted to the statement of income over a period of five years. The amount deducted from the balance of the non-monetary assets, as stated above, will be expensed concurrently with consumption or depreciation of these assets. The consequences of that described above on the business results in the financial statements for the period of the report amounted to a decrease in expenses (net) of NIS 11.5 million (share of Polar Investments), of which NIS 1.5 million in the third quarter (share of Polar Investments).

The profit realized by Polar Investments, in an amount of NIS 23.7 million, as a result of the sale of Polar Trade shares, as above, (taking into consideration the aforementioned option), is presented as deferred income in Polar Investments' financial statements and will be recognized over a three-year period or up to the share of Polar Investments in the losses of the Day Italy (should such losses be incurred), whichever amount is higher based on a cumulative calculation. As a result, in the period of the report, the amount of NIS 2.9 million was recognized out of the aforementioned income.

In October 2004 the Investor exercised the put option it received as aforementioned and accordingly Polar Investments purchased all the Investor's holdings in Polar Trade (7.66%) and in Day Telecom (20%) for the price of € 1 million.

For further details on Day Italy, including a legal claim that was filed against, inter alia, Day Italy and Polar Investments, see also Note 3C(8) of the financial statements.

#### **4.4.4.2 Transclal Trading Ltd. ("Transclal")**

In the period of the report and up to the date of its publication, Polar Investments sold most of its holdings in Transclal for the total price of NIS 46.1 million and a capital gain (before tax) of NIS 13.8 million, NIS 8.3 million of which will be included in its financial statements for the fourth quarter.

As a result of the aforementioned sale, Polar Investments stopped being an interested party of Transclal subsequent to balance sheet date, see also Note 3C(5) of the financial statements.

#### **4.4.4.3 Hatzerot Hadar Ltd. ("Hatzerot Hadar")**

In March 2004, upon receipt of the approval of the Supervisor of Restrictive Business Practices, Polar Investments completed the sale of all of its holdings (46%) in Hatzerot Hadar, a company engaged in the area of sheltered housing for the elderly, for the amount of NIS 21.4 million, including the endorsement to the purchaser of a debt Polar Investments has toward Hatzerot Hadar.

As a result of completion of the above sale, a pre-tax capital gain of NIS 4.6 million was included in the consolidated financial statements of Leader for the period of the report.

#### **4.4.4.4 Grand Auto d.o.o. ("Grand Auto")**

In February 2004, Polar Investments acquired (directly and indirectly) through a partnership it established with a third party in equal parts, 80% of the share capital of Grand Auto for a consideration of €3.8 million.

The share of Polar Investments (50%) in Grand Auto's revenues that was included in its financial statements for the period of the report and the third quarter amounted to NIS 51.7 million and NIS 19.0 million, respectively.

#### **4.4.5 Additional investments**

##### **Dor Chemicals Ltd. (“Dor”)**

Dor is a public company, the shares of which are traded on the Stock Exchange, which operates, mainly, outside of Israel in the manufacturing, marketing and selling of various kinds of multi-layer polypropylene sheets that are used as packaging and wrapping material for the food, tobacco, medical instrument, and other industries. Polar Investments holds 10.7% of the shares of Dor.

In August 2004 the conditions of an agreement between the banks and a subsidiary of Dor (“the subsidiary” which manages the BOPP activity) were fulfilled. In the agreement it was agreed, inter alia, that the banks would waive the breach of the financing agreements, including the non-compliance of the subsidiary with certain financial covenants, and new financial ratios were provided on the basis of the updated business plan that was approved by the banks’ external consultants. In addition, Dor provided to the subsidiary shareholders’ loans in the amount of €10 million for the repayment of bank loans.

In accordance with the most recent financial statements of Dor for June 30, 2004, which were published on August 31, 2004, the subsidiary is in compliance with the new financial ratios that were set as aforementioned, the loans provided by the banks to the subsidiary were reclassified as long-term loans and the auditors of Dor removed their remark on this matter from their report. See also Note 3C(9) of the financial statements.

The market value of the investment of Polar Investments in Dor close to the date of the drafting of the financial statements amounted to NIS 10 million, compared with the value on the books of Polar Investments which amounted to NIS 38 million. Polar Investments evaluate that as at the signing date of the financial statements, the difference between the market value of the investment of Polar Investments in Dor and its book value does not reflect a permanent decline in value.

#### **4.5 Kamor Ltd. (“Kamor”)**

Kamor is engaged directly and through its subsidiaries in a number of sectors, the principal ones being: vehicle imports, real estate, finance, and shipping.

In the area of vehicles, Kamor holds 71% of Kamor Motor Vehicles, which is engaged in the importing and marketing of motor vehicles and spare parts (BMW). In the real estate area, Kamor holds a number of rental real estate properties as well as real estate under development which is designated for rent.

In the period of the report, the revenues and sales of Kamor amounted to NIS 395 million, compared with NIS 231 million during the corresponding period last year.

Kamor finished the period of the report with net income of NIS 12.9 million (NIS 6.0 million in the quarter), compared with net income of NIS 3.0 million in the corresponding period last year (NIS 1.0 million in the corresponding quarter last year).

As at balance sheet date, Leader held 21.0% of Kamor’s share capital. The investment in Kamor is recorded on the equity basis in Leader’s books and, as at September 30, 2004, it amounts to NIS 26.2 million.

In the period of the report, Kamor raised NIS 47 million through an issuance of debentures. Leader Issuances served as the manager of the consortium of underwriters for this issuance.

#### **4.6 BSR Europe Ltd. (“BSR”)**

BSR, a public company whose shares are traded on the stock exchange, is engaged through its investee companies in the initiation, development, construction, rental, management and improvement of various projects in the field of real estate in six countries in Eastern and Central Europe. BSR operates in two main investment sectors in the real estate area – investment in rental properties and the initiation of office and residential projects.

BSR finished the period of the report with income of NIS 44.1 million (income of NIS 9.9 million in the quarter), compared with a loss of NIS 1.1 million in the corresponding period last year (a loss of NIS 2.6 million in the corresponding quarter last year).

During the period of the report, Leader invested NIS 8.5 million in shares and options of BSR, and its effective rate of holding in BSR increased to 35.2%.

As at September 30, 2004, the investment in BSR on Leader’s books amounted to NIS 77.2 million, including an investment of NIS 31.4 million in debentures.

In February 2004, BSR published a prospectus whereby it raised NIS 60 million by way of an issuance of debentures and options. Leader Issuances served as the manager of the consortium of underwriters for this issuance.

During the period of the report, BSR completed the sale of real estate in Slovakia. The pre-tax income recorded by BSR in the period of the report from the aforesaid sale amounted to NIS 74 million, NIS 12 million of which in the quarter.

In the period of the report, BSR, through its subsidiary which is registered in The Netherlands (in which BSR holds an 82.3% interest), and a third party unrelated to BSR (“the sellers”), signed an in-principle agreement with an international investment fund specializing in real estate, pursuant to which they would sell 65% of their rights in an investee company registered in Poland (the subsidiary’s share is 57.2%) so that after the sale the subsidiary will hold 20% of the share capital of the Polish company. The Polish company is engaged in the initiation and construction of a real estate project in Krakow. The consideration to be paid by the fund to the sellers in respect of the rights being sold will be calculated based on a value for the Polish company of €21.5 million. Accordingly, the proceeds expected to be received by BSR, including the repayment of shareholders’ loans, will amount to €6.3 million. BSR is expected to record a gain of €2.5 million on the sale.

The validity of the agreement is subject to the approval of the aforementioned fund’s board of directors and to completion of a due diligence examination to the satisfaction of the fund.

In the period of the report, BSR declared a dividend in the amount of NIS 24 million. The share of Leader in the dividend, which was received subsequent to balance sheet date, amounted to NIS 7.9 million. See Note 3B(2) of the financial statements for further events in BSR in the period of the report.

#### **4.7 A.M.S. Electronics Ltd. (“AMS”)**

AMS is engaged mainly in the assembly of electronic components on printed circuit boards. As part of the service it renders to its customers, it is also involved in the assembly of complementary components.

As at balance sheet date, Leader effectively holds 21% of the share capital of AMS. As at September 30, 2004, the investment in AMS on Leader’s books amounted to NIS 7.2 million.

In the period of the report, Leader entered into an agreement with AMS for sale of all of its holdings (through a wholly-owned subsidiary) in AMS.

In exchange for the shares sold, AMS is to pay to the subsidiary of Leader the amount of NIS 7.5 million plus linkage differences from the signing date of the agreement up to the execution date thereof.

Completion of the agreement is subject to fulfillment of a number of preconditions, according to which AMS must comply with an income test and a repayment ability test (hereinafter – “the Preconditions”). See also Note 3B(5) of the financial statements.

Subsequent to balance sheet date AMS announced that according to its financial statements for September 30, 2004 it is possible to distribute the amount of NIS 3.9 million. Accordingly, Leader sold 485,000 shares of AMS for the price of NIS 3.9 million. Execution of the agreement regarding the rest of the shares included in the agreement (454,675 shares of AMS) is subject to further examination of the compliance of AMS with the income and repayment ability tests, and is subject to the right of Leader to sell the shares to a third party, according to the provisions of the agreement. Furthermore, at the same time Leader entered into an agreement with AMS by which Leader and/or a company under its control would provide to AMS ongoing financial consultancy services for the price of NIS 62.5 thousand per month.

## **4.8 Advanced Technologies and Management of Venture Capital Funds**

### **4.8.1 Shrem, Fudim, Kelner – Technologies Ltd. (“Technologies”)**

Technologies invests in various fields of technology, in companies that invest in entities engaged in technology, in companies which themselves invest in venture capital funds and in companies that manage hi-tech investment funds. Technologies is also engaged in the provision of advisory and management services to corporations engaged in technology.

The beginning of 2003 was characterized by the continued decrease in value of the technology companies on the capital markets and by the continued and worsening slowdown in venture capital investments. As a result, the ability of technology companies to raise capital or to be purchased by leading public companies whose own market value was significantly reduced was also reduced. In the second half of 2003, a positive change both in the financial markets and the fields of technological activity was noticeable and the trend continued during the period of the report. This followed years of a continued slowdown in the capital markets in general and the venture capital industry in particular.

Technologies concluded the period of the report with net income of NIS 2.2 million (a loss of NIS 3.6 million in the corresponding period of 2003). The income derived mainly from the share of Technologies in the income of an affiliated company (ADT), from gains on marketable securities in respect of the share of Technologies in the Sphere Fund and from net gains on investments and loans, as described below. As at September 30, 2004, the shareholders' equity of Technologies amounted to NIS 80.2 million, compared with NIS 78.5 million as at December 31, 2003, and constituted 55% of the total balance sheet. The increase in the shareholders' equity in the period of the report derives mainly from the income for the period.

The net asset value of the investment in Technologies on the books of the Company, as at September 30, 2004, amounted to NIS 46.7 million. As at the end of the period of the report, the Company holds a 61.0% interest in Technologies.

Technologies' policy is to maintain an operational breakeven so that its current revenues, which amounted to NIS 14.3 million in the period of the report, are equal to or higher than its salary and salary-related expenses, general and administrative expenses and the management fees paid by Technologies, which in the period of the report amounted to NIS 12.2 million.

**We present below the major changes in the investments of Technologies:**

- During the period of the report, the Pitango 2 Fund, managed by DS Polaris Ltd. (a subsidiary of Technologies), set up a continuation fund of U.S.\$ 10 million. The aim of the fund is to continue investing in companies of Pitango 2 which have potential for business development. The share of DS Polaris in the continuation fund is U.S.\$0.5 million. As manager of the fund, DS Polaris is entitled to receive “success fees”.
- During the period of the report, Technologies invested, in accordance with the Platinum Fund’s request for money, an amount of U.S.\$1,960 thousand, comprising 14% of Technologies’ commitment to the Platinum Fund (managed by Technologies).
- For purposes of preparation of the 2003 financial statements, an overall valuation of the worth of Persay Inc. was performed by an external appraiser. The valuation served as the basis for determining the book value of Persay as at the balance sheet date and the valuation was attached to Technologies financial statements as at December 31, 2003. The value determined for Persay in the aforementioned valuation was between NIS 12.9 million and NIS 16.4 million.
- **Advanced Dicing Technologies (“ADT”)** is engaged in manufacturing cutting equipment for the microelectronic market and the blades used in such equipment. Technologies holds 23% of the issued and paid-up capital of ADT. Commencing in the fourth quarter of 2003, Technologies began recording its share in the income of ADT.

During the period of the report, after receiving the approval of the board of directors, Technologies sold 20% of its investment in ADT (comprising 5.8% of the issued and paid-up share capital of ADT) to the Platinum Fund, a related party, for an amount equal to the cost of the investment on the books of Technologies and part of the future graded “success fee” to be earned by the Platinum Fund from ADT for a period of up to nine months from the date of sale.

- **Danbar Technologies Ltd. (“Danbar”) (percentage held 10.8%)**

As part of the preparation of the 2003 financial statements, and as part of the assessment of the investment of Technologies in Danbar, an overall assessment was made of the book value of Danbar’s venture capital investments, with the assistance of an external appraiser. The appraisal served as the basis for determining the book value of Danbar’s venture capital investments as at the balance sheet date and it was attached to the financial statements of Technologies as at December 31, 2003. The value of Danbar according to the aforementioned valuation is NIS 36.3-41.2 million. The value of Technologies’ share in this amount is NIS 3.9-4.4 million.

- **Crow Technologies (1977) Ltd. (“Crow”)**

In the period of the report, the Company and Technologies sold to a third party, shares of Crow constituting 4.2% of Crow’s issued and paid-up share capital, for a consideration of \$791 thousand. Pursuant to the evaluation of the managements of the Company and of Technologies, which is based on, among other things, the transaction price described above, in the period of the report the Company and Technologies recorded gains in the amount of NIS 0.7 million and NIS 1.4 million, respectively, from elimination of part of the provisions for decline in value of their investments in Crow, that were set up on the books of the Company and Technologies during 2001 and 2002.

- **E.E.R.** – for more information on Technologies investment, see Section 4.3.3 above.

#### **4.8.2 Leader Tech Ltd. (“Leader Tech”)**

Leader Tech, a public company whose shares are traded on the stock exchange, is engaged, both directly and indirectly, in the acquisition, holding and realization of entities, whose main fields of activity are venture capital and technology, including communications, internet, biotechnology, computers, etc. It also invests in companies that themselves invest in other entities that are engaged in similar activities.

Leader Tech concluded the period of the report and the quarter with a loss of NIS 2.6 million and NIS 1.1 million, respectively, compared with a loss of NIS 2.3 million and NIS 1.7 million, respectively, in the corresponding periods last year.

As at balance sheet date, Leader held 66.5% of the share capital of Leader Tech. The net asset value of the investment in Leader Tech on Leader’s books, as at September 30, 2004, amounted to NIS 21.5 million.

#### **4.9 SFK – Kanaf 2000 Financing Ltd. (“Kanaf 2000”)**

Kanaf 2000 is engaged in investment portfolio consulting, financial advice and planning, management of a circle of clients and marketing initiations to its clients.

Kanaf 2000 is held by the Company (indirectly) at a percentage of 75%.

Since inception, Kanaf 2000’s circle of clients have participated in investments which include, among other things, investments in real estate in Europe in an amount of NIS 75 million (mainly Eastern Europe), in real estate in the U.S. in an amount of NIS 15 million, structured deposits in an amount of NIS 33 million, and investments in technological fields in an amount of NIS 9 million. The turnover regarding which Kanaf 2000 provided consultancy services is estimated at NIS 500 million.

#### **4.10 Sphere Fund (“Sphere”)**

The Sphere Fund was set up on January 1, 2004, in accordance with the approval of the Company’s Board of Directors to set up a fund for investing in marketable securities. The Fund is managed by a management company controlled by the Company, together with the former Nostro managers of the Company. The Company is entitled to management fees of 1.5% of the volume of the Fund and 20% of its profits, as defined in the agreement for the investment in the Fund. The former Nostro managers are entitled to half of the management fees and profits of the management company. As at the date of publishing the financial statements, as a result of additional investments and the profits accumulated by Fund, the volume of the Fund is in excess of \$ 60 million.

#### **4.11 Shrem, Fudim, Kelner – Financing and Projects Ltd. (“Financing and Projects”)**

The Company holds 66% of the share capital of Financing and Projects, which is engaged mainly in consulting in the area of investment banking. For information regarding the agreement between Financing and Projects and BSR, see Note 3B2 of the financial statements.

In addition, during the period of the report, Financing and Projects served as a consultant for fundraising for other companies, including BSR and the Angel Group.

#### **4.12 Dirad Investments Ltd. (“Dirad”)**

Dirad is a private company in which the Company holds 28.67% of its share capital. In the third quarter of 2004, certain of Dirad’s indirect investments were realized for the total price of \$ 112 million. Following this sale, Dirad recorded a gain in the amount of NIS 19.4 million in the third quarter of 2004. Dirad recorded the aforementioned gain on the basis of the proceeds that were actually received and not on the basis of the financial statements of the companies which realized the investments. The share of the Company in the gain of Dirad on the sale amounts to NIS 5.6 million.

### **5. Major Events During and Subsequent to the Period of the Report**

**5.1** The Company, Mr. Izhak Shrem and others (hereinafter – the defendants) were sued by alligator hunters from Florida, USA, for the amount of \$ 1.2 million and punitive damages (hereinafter – the Florida claim), and in the framework of a third party notice – in a counterclaim (as amended) the Company and Mr. Shrem were sued for the amount of \$ 3.1 million and punitive damages (hereinafter – the counterclaim) by CCF, which is under the control of Mr. Shlomi Rinot from Israel and its subsidiary in Florida (hereinafter – the plaintiffs).

In a mediation proceeding the Florida claim was dismissed against the payment of \$ 487,500 to the alligator hunters.

On December 12, 2003, after the plaintiffs finished the presentation of evidence, the Court orally ruled in favor of the Company and Mr. Shrem without needing to hear their testimonies. On January 5, 2004 the ruling, by which the counterclaim was rejected in its entirety, was provided in writing.

On May 7, 2004, the plaintiffs submitted an appeal on the ruling to the Florida District Appellate Court. The plaintiffs did not appeal the rejection of the claim of fraud against Mr. Izhak Shrem, but appealed the rejection of the other causes in their claim against the Company and Izhak Shrem.

On November 17, 2004 the Florida District Appellate Court rejected the appeal of the plaintiffs and unanimously upheld the ruling. This ruling will become final and absolute after 30 days have passed, in which the plaintiffs can request from the Supreme Court of Florida permission to appeal. In the opinion of the Company’s legal counsel, the chances of the plaintiffs that the Supreme Court will accept the request, if made, are slim.

In light of the aforementioned, the management of the Company decided in its financial statements for the third quarter of 2004 to cancel the provisions made in the past in respect of this claim.

**5.2** During the period of the report, NIS 3,500 thousand par value debentures (Series B) of the Company were converted into 437,500 ordinary shares of NIS 1 par value each of the Company.

**5.3** During the period of the report, the Company converted 15,925 par value debentures into 1,990,625 shares of Leader. In addition, the Company exercised all of the Series I options it held into 3,733,150 par value shares of Leader, for an amount of NIS 15 million, and an outside investor of Leader converted 450,000 par value debentures into 56,250 shares of Leader

**5.4** In June 2004, Leader and an overseas investor with which it had signed a memorandum of understanding in December 2003, by which the investor was to grant to Leader a loan that is convertible into shares of Polar Investments, decided not to proceed with the transaction that is the subject of the memorandum of understanding.

At the same time, Polar Investments and the above-mentioned investor also decided not to proceed with the transaction between them, which is the subject of the memorandum of understanding they signed in December 2003, in connection with the investor's investment in Polar Investments.

- 5.5** In February 2004, following receipt of court approval for execution of a distribution that does not pass the "income test", Ytong Industries distributed the amount of NIS 80 million as a dividend to its shareholders. The share of Urdan and Orlite in the distribution was 15.4% and 69.8%, respectively.

In May 2004, following receipt of court approval for execution of an additional distribution that does not pass the "income test", Ytong Industries distributed to its shareholders a dividend in the amount of NIS 55 million. The share of Urdan and Orlite in the distribution was 15.2% and 68.7%, respectively.

- 5.6** As part of its strategic plan, Polar Investments continued in the reorganization of the structure of its financial liabilities and the terms thereof, including reduction of the overall balance of its financial liabilities, net, which decreased in the period of the report by NIS 80 million and which, as at the balance sheet date, total NIS 600 million (Polar alone).

Polar Investments completed receipt of additional long-term credit lines from banks in a total amount of NIS 136 million (mostly unutilized) and is taking steps to set down in writing all of the in-principle agreements with another bank for the receipt of an additional credit line in an amount of NIS 46 million, most of which is utilized.

- 5.7** In July 2004, Ma'alot The Israeli Securities Rating Company Ltd. raised the rating of the debentures of Polar Investments by two rates to a rating of BBB+. In its work Ma'alot noted that it positively views the actions of Polar Investments and its intentions to continue to reduce the amount of its debt while creating long-term growth generators and improving its financial ratios in general and its debt coverage ratios in particular, and that it will continue to follow these developments and to positively examine their effects on the rating of Polar Investments' debentures.

- 5.8** On August 18, 2004, the Audit Committee and Board of Directors of Technologies approved a plan for issuance of 1,600,000 non-marketable options convertible into ordinary shares of NIS 0.01 par value of Technologies. The offerees under the aforementioned plan are the CEO of Technologies (897,133 options) and company employees (702,867 options).

- 5.9** On August 18, 2004, the Audit Committee and Board of Directors of Technologies approved an update of the employment conditions of the CEO of Technologies, such that the bonus to which he is entitled will be calculated based on the annual income (including results of affiliated companies) before taxes and before the bonus and without taking into account losses of prior years, if any.

- 5.10** As to the ruling on the claim that was filed against Leader, a former officer of Leader and others with respect to a prospectus for the issuance of securities of Orsyx Ltd., see Note 4B of the financial statements.

- 5.11** Subsequent to balance sheet date, the Company's Board of Directors decided on a private issuance to the CEO of a subsidiary of 400,000 non-marketable option warrants, exercisable into ordinary shares of NIS 1 par value. The shares that will be issued in the future upon the exercise of such options will be issued in a manner that reflects the benefit component embodied in the options, as calculated on the date of their exercise. The CEO of the subsidiary will become entitled to the offered options after two years have passed and until the end of five years, and they are exercisable over a period of 6 years.

## **6. Contributions**

The Company considers contribution to the community to be an important part of its business activity and therefore it contributes together with Leader, in equal portions, in the framework of the DS Fund, which is a registered association recognized as a not for profit entity. The main aim of the association as was determined upon its establishment is as follows: "to establish a fund in Israel for making contributions to charity organizations and activities, to institutions, to the needy and indigent, to educational, sport, art, science and research institutes, student scholarships, health, welfare and medicine". In the period of the report, the amounts of the contributions made by the Company and the consolidated group (including the contributions of subsidiaries of the Company) were NIS 354 thousand and NIS 1,200 thousand, respectively. In 2003, the amounts of the contributions made by the Company and the consolidated group totaled NIS 314 thousand and NIS 1,215 thousand, respectively.

## **7. Qualitative Report on Exposure to Market Risks and their Management**

There were no material changes in the exposure of the Company to market risks and the management thereof from the description presented in the Company's latest annual financial statements and the attached report of the Board of Directors.

## **8. Derivative Transactions**

A subsidiary of Urdan has "call" options for the purchase of dollars against shekels as follows: \$8,100 thousand at exercise prices ranging between 4.62 and 4.7, with a fair value of NIS 82 thousand, and it sold "put" options in the total amount of \$8,100 thousand at exercise prices ranging between 4.40 and 4.45, the fair value of which is a liability of NIS 133 thousand and a call option in the total amount of \$1,500 thousand at an exercise price of 4.95, the fair value of which is zero. These transactions are for the period until March 31, 2005. The maximum holding of the subsidiary in derivatives in the period of the report was \$ 9,000 thousand "call" options. The maximum sale was \$9,000 thousand "put" options and \$3,000 thousand "call" options. The maximum holding of the subsidiary in derivatives was on June 30, 2004. The aforementioned transactions were intended for hedging against the exposure in the area of foreign currency supplier credit.

Another subsidiary of Urdan has open forward transactions as at September 30, 2004, as follows: \$2,150 thousand, and an additional €250 thousand. These transactions are for a period of up to one year and are designated for hedging purposes. Their fair value is a gain of NIS 110 thousand. The maximum holding in derivatives during the period of the report was an amount of NIS 19,352 thousand, between June 10, 2004 and June 15, 2004. The transactions are intended for hedging purposes.

Subsequent to balance sheet date the subsidiary of Urdan executed additional forward transactions by purchasing \$ 2,500 thousand, which as at the end of the period are worth NIS 11,246 thousand. The transactions are for a period of up to one year and are intended for hedging purposes.

In light of there being dollar liabilities on the books of the Company and the private companies under its control, the Company and the private companies under its control occasionally execute hedging transactions against exposure to changes in the exchange rate of the dollar. As at September 30, 2004 there were no such open transactions. The results of the aforementioned transactions in the period of the report are immaterial.

As at the balance sheet date, the Company, Leader and Polar Investments had no material holdings in derivative financial instruments.

In addition to the above, the Company and Leader, directly and through their subsidiary, are active in the "Ma'of" derivatives market through the purchase and sale of financial derivative instruments. The exposure as a result of these transactions in the period of the report did not exceed NIS 10 million, for each one of them.

9. Linkage Basis Report (in reported NIS millions):

	Financial balances			Non-financial balances	Total
	In foreign currency or linked thereto	Linked to the CPI	Unlinked		
<b>As at September 30, 2004</b>					
<b>Assets:</b>					
Current assets	402.6	41.0	644.4	430.8	1,518.8
Real estate	-	-	-	513.9	513.9
Long-term investments and loans	123.7	216.2	58.6	1,448.5	1,847.0
	<b>526.3</b>	<b>257.2</b>	<b>703.0</b>	<b>2,393.2</b>	<b>3,879.7</b>
<b>Liabilities:</b>					
Current liabilities	286.8	239.4	973.6	55.2	1,555.0
Long-term liabilities	157.2	816.7	601.1	37.2	1,612.2
Minority interest and options in subsidiaries	-	-	-	500.6	500.6
	<b>444.0</b>	<b>1,056.1</b>	<b>1,574.7</b>	<b>593.0</b>	<b>3,667.8</b>
<b>Total balance, net</b>	<b>82.3</b>	<b>(798.9)</b>	<b>(871.7)</b>	<b>1,800.2</b>	<b>211.9</b>

**Linkage Basis Report (in NIS millions of December 2003):**

	Financial balances			Non-financial balances	Total
	In foreign currency or linked thereto	Linked to the CPI	Unlinked		
<b>As at December 31, 2003</b>					
<b>Assets:</b>					
Current assets	402.0	63.8	687.7	347.1	1,500.6
Real estate	-	-	-	530.4	530.4
Long-term investments and loans	115.8	231.0	33.1	1,553.5	1,933.4
<b>Total assets attributed to continuing operations</b>	<b>517.8</b>	<b>294.8</b>	<b>720.8</b>	<b>2,431.0</b>	<b>3,964.4</b>
Total assets attributed to discontinued operations	-	-	-	15.6	15.6
<b>Total</b>	<b>517.8</b>	<b>294.8</b>	<b>720.8</b>	<b>2,446.6</b>	<b>3,980.0</b>
<b>Liabilities:</b>					
Current liabilities	164.6	206.6	1,176.9	23.5	1,571.6
Long-term liabilities	121.1	1,042.7	628.1	29.6	1,821.5
Minority interest and options in subsidiaries	-	-	-	404.8	404.8
<b>Total liabilities attributed to continuing operations</b>	<b>285.7</b>	<b>1,249.3</b>	<b>1,805.0</b>	<b>457.90</b>	<b>3,797.9</b>
Total liabilities attributed to discontinued operations	-	-	-	15.3	15.3
<b>Total</b>	<b>285.7</b>	<b>1,249.3</b>	<b>1,805.0</b>	<b>473.2</b>	<b>3,813.2</b>
<b>Total balance, net</b>	<b>232.1</b>	<b>(954.5)</b>	<b>(1,084.2)</b>	<b>1,973.4</b>	<b>166.8</b>

The Company wishes to thank the employees for their contribution to the Company and the shareholders for their loyalty.

**Izhak Shrem**  
Chairman of the  
Board of Directors

**Yair Fudim**  
CEO and Member of the  
Board of Directors

November 30, 2004

**Shrem, Fudim, Kelner and  
Company Ltd.**

**Financial Statements  
As at September 30, 2004  
(Unaudited)**

**Consolidated Balance Sheets**

	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	December 31 *2003 (Audited)
	Reported amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	
<b>Current assets</b>			
Cash and cash equivalents	241,431	279,865	289,518
Deposits and short-term investments	80,114	48,908	17,095
Marketable securities	175,361	194,705	243,706
Current maturities and loans receivable	20,324	51,651	26,923
Trade receivables	475,444	361,322	389,931
Other receivables	129,522	100,849	211,327
Inventory and work-in-process	396,640	274,646	322,163
	<b>1,518,836</b>	<b>1,311,946</b>	<b>1,500,663</b>
	<b>513,916</b>	<b>620,638</b>	<b>530,441</b>
<b>Real estate</b>			
<b>Investments and long-term loans</b>			
Investments in investee and other companies	946,595	951,491	926,083
Loans and deposits	63,166	31,999	54,388
	<b>1,009,761</b>	<b>983,490</b>	<b>980,471</b>
	<b>711,580</b>	<b>766,880</b>	<b>787,957</b>
<b>Fixed assets</b>			
	<b>125,502</b>	<b>100,919</b>	<b>164,819</b>
<b>Other assets and deferred expenses</b>			
	-	565,914	15,641
<b>Assets attributed to discontinued operations</b>			
	<b>3,879,595</b>	<b>4,349,787</b>	<b>3,979,992</b>
<b>Current liabilities</b>			
Credit from banks and others	874,214	771,521	937,519
Suppliers and service providers	302,415	188,104	240,855
Accounts payable and credit balances	310,550	245,401	337,898
Customer deposits	67,778	77,388	55,293
	<b>1,554,957</b>	<b>1,282,414</b>	<b>1,571,565</b>
<b>Long-term liabilities</b>			
Credit from banks and others	1,179,804	1,369,979	1,313,995
Debentures	154,892	219,210	196,542
Debentures convertible into shares	247,781	298,991	279,230
Employee retirement benefit, net	19,351	10,410	18,697
Deferred taxes	10,371	7,342	13,052
	<b>1,612,199</b>	<b>1,905,932</b>	<b>1,821,516</b>
	-	555,827	15,316
<b>Liabilities attributed to discontinued operations</b>			
	<b>487,055</b>	<b>401,468</b>	<b>392,024</b>
<b>Minority interest</b>			

	<u>13,513</u>	<u>29,836</u>	<u>12,793</u>
<i>Receipts from share options issued by subsidiaries</i>			
	<u>211,871</u>	<u>174,310</u>	<u>166,778</u>
<i>Shareholders' equity</i>			
	<u><u>3,879,595</u></u>	<u><u>4,349,787</u></u>	<u><u>3,979,992</u></u>

\* Reclassified, including discontinued operations.

\*\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

Date of approval: November 30, 2004

**Consolidated Statements of Operations**

	For the nine months ended		For the three months ended		For the year ended
	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	December 31 2003 (Audited)
	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands
<b>Income</b>					
Income from sales, services, consulting, management and underwriting	1,362,040	1,031,728	449,701	343,269	1,376,339
Gain on marketable securities, net	21,210	67,913	3,318	34,559	110,536
Gain on sales of investments, loans and assets, net	167,299	4,148	77,535	10,048	* -
Company's equity in earnings of affiliated companies	38,819	8,868	9,477	-	10,857
	<b>1,589,368</b>	<b>1,112,657</b>	<b>540,031</b>	<b>387,876</b>	<b>1,497,732</b>
<b>Costs and expenses</b>					
Cost of sales and services	1,023,868	752,828	338,114	255,274	999,130
Selling and marketing	132,250	120,270	41,581	41,641	161,490
General and administrative	194,287	167,123	71,490	52,141	233,956
Loss on sales of investments, loans and assets, net	-	-	-	-	* 1,402
The Company's equity in the losses of affiliated companies	-	-	-	2,843	-
Financing expenses, net	112,486	130,956	35,580	51,944	177,620
	<b>1,462,891</b>	<b>1,171,177</b>	<b>486,765</b>	<b>403,843</b>	<b>1,573,598</b>
<b>Earnings (loss) before taxes on income</b>	<b>126,477</b>	<b>(58,520)</b>	<b>53,266</b>	<b>(15,967)</b>	<b>(75,866)</b>
Taxes on income	33,132	10,836	18,294	4,569	(16,287)
<b>Earnings (loss) from operations after taxes on income</b>	<b>93,345</b>	<b>(69,356)</b>	<b>34,972</b>	<b>(20,536)</b>	<b>(92,153)</b>
Minority interest in losses earnings of subsidiaries, net	(54,219)	54,635	(24,701)	13,667	68,985
Gain (loss) attributed to continued operations	39,126	(14,721)	10,271	(6,869)	(23,168)
Loss attributed to discontinued operations	-	(9,494)	-	(342)	(9,729)
<b>Net earnings (loss) for the period</b>	<b>39,126</b>	<b>(24,215)</b>	<b>10,271</b>	<b>(7,211)</b>	<b>(32,897)</b>
<b>Earnings (loss) per NIS 1 par value</b>					
<b>of the ordinary share capital:</b>					
Basic earnings (loss) per share from continued operations	2.13	(0.91)	0.56	(0.39)	(1.40)
Basic loss per share from discontinued operations	-	(0.59)	-	(0.02)	(0.58)
Basic earnings (loss) per share	<b>2.13</b>	<b>(1.50)</b>	<b>0.56</b>	<b>(0.41)</b>	<b>(1.98)</b>
<b>Diluted earnings (loss) per share</b>					
from continued operation	1.97	(0.91)	0.51	(0.39)	(1.40)
Diluted loss per share from discontinued operation	-	(0.59)	-	(0.02)	(0.58)
Diluted earnings (loss) per share	<b>1.97</b>	<b>(1.50)</b>	<b>0.51</b>	<b>(0.41)</b>	<b>(1.98)</b>

\* Reclassified, including discontinued operations.

\*\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

**Statements of Changes in Shareholders' Equity**

	Share capital	Premium on shares and capital reserves	Adjustments from the translation of financial statements of autonomous foreign investees of an affiliate	Loans to employees for the purchase of shares	Company shares held by the Company and subsidiary	Retained earnings (losses)	Total
	Reported Amounts*						
	NIS thousands						
<b>Nine month period ended September 30, 2004 (Unaudited)</b>							
<b>Balance as at January 1, 2004 (Audited)</b>	24,923	162,223	4,981	(3,194)	(4,691)	(17,464)	166,778
Sale of Company shares	-	(379)	-	-	2,240	-	1,861
Conversion of debentures into shares of the Company (1)	437	2,876	-	-	-	-	3,313
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	793	-	-	-	793
Net earnings for the period	-	-	-	-	-	39,126	39,126
<b>Balance as at September 30, 2004</b>	<b>25,360</b>	<b>164,720</b>	<b>5,774</b>	<b>(3,194)</b>	<b>(2,451)</b>	<b>21,662</b>	<b>211,871</b>

(1) In the current period NIS 3,500 thousand par value of debentures were converted into 437 thousand ordinary shares of the Company. As at balance sheet date the balance of the debentures is a par value of NIS 13,500 thousand.

\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

**Statements of Changes in Shareholders' Equity (cont'd)**

	Share capital	Premium on shares and capital reserves	Adjustments from the translation of financial statements of autonomous foreign investees of an affiliate	Loans to employees for the purchase of shares	Company shares held by the Company and subsidiary	Retained earnings (losses)	Total
Amounts adjusted to the effect of inflation in terms of NIS of December 2003							
NIS thousands							
<b>Nine month period ended September 30, 2003 (Unaudited)</b>							
<b>Balance as at January 1, 2003 (Audited)</b>	21,917	137,332	3,354	(3,194)	(4,585)	15,433	170,257
Purchase of Company shares	-	-	-	-	(106)	-	(106)
Issuance of shares	3,006	26,118	-	-	-	-	29,124
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	(750)	-	-	-	(750)
Loss for the period	-	-	-	-	-	(24,215)	(24,215)
<b>Balance as at September 30, 2003</b>	<b>24,923</b>	<b>163,450</b>	<b>2,604</b>	<b>(3,194)</b>	<b>(4,691)</b>	<b>(8,782)</b>	<b>174,310</b>

**Statements of Changes in Shareholders' Equity (cont'd)**

	Share capital	Premium on shares and capital reserves	Adjustments from the translation of financial statements of autonomous foreign investees of an affiliate	Loans to employees for the purchase of shares	Company shares held by the Company and subsidiary	Retained earnings (losses)	Total
	Reported Amounts*						
NIS thousands							
<b>Three month period ended September 30, 2004 (Unaudited)</b>							
<b>Balance as at July 1, 2004 (Unaudited)</b>	25,360	164,720	4,910	(3,194)	(2,451)	11,391	200,736
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	864	-	-	-	864
Net earnings for the period	-	-	-	-	-	10,271	10,271
<b>Balance as at September 30, 2004</b>	<b>25,360</b>	<b>164,720</b>	<b>5,774</b>	<b>(3,194)</b>	<b>(2,451)</b>	<b>21,662</b>	<b>211,871</b>

\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

**Statements of Changes in Shareholders' Equity (cont'd)**

	Share capital	Premium on shares and capital reserves	Adjustments from the translation of financial statements of autonomous foreign investees of an affiliate	Loans to employees for the purchase of shares	Company shares held by the Company and subsidiary	Retained earnings (losses)	Total
<i>Amounts adjusted to the effect of inflation in terms of NIS of December 2003</i>							
<b>NIS thousands</b>							
<b>Three month period ended September 30, 2003 (Unaudited)</b>							
Balance as at July 1, 2003 (Unaudited)	24,923	163,450	(650)	(3,194)	(4,691)	(1,571)	178,267
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	3,254	-	-	-	3,254
Loss for the period	-	-	-	-	-	(7,211)	(7,211)
<b>Balance as at September 30, 2003</b>	<b>24,923</b>	<b>163,450</b>	<b>2,604</b>	<b>(3,194)</b>	<b>(4,691)</b>	<b>(8,782)</b>	<b>174,310</b>

**Statements of Changes in Shareholders' Equity (cont'd)**

	Share capital	Premium on shares and capital reserves	Adjustments from the translation of financial statements of autonomous foreign investees of an affiliate	Loans to employees for the purchase of shares	Company shares held by the Company and subsidiary	Retained earnings (losses)	Total
<i>Amounts adjusted to the effect of inflation in terms of NIS of December 2003</i>							
<b>NIS thousands</b>							
<b>Year ended December 31, 2003 (Audited)</b>							
<b>Balance as at January 1, 2003 (Audited)</b>	21,917	137,332	3,354	(3,194)	(4,585)	15,433	170,257
Changes in 2003:							
Private issuance of shares, net	3,006	26,118	-	-	-	-	29,124
Purchase of Company shares by subsidiary	-	-	-	-	(106)	-	(106)
Changes in capital reserves in respect of investee Companies	-	(1,227)	-	-	-	-	(1,227)
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	1,627	-	-	-	1,627
Loss for the year	-	-	-	-	-	(32,897)	(32,897)
<b>Balance as at December 31, 2003</b>	<b>24,923</b>	<b>162,223</b>	<b>4,981</b>	<b>(3,194)</b>	<b>(4,691)</b>	<b>(17,464)</b>	<b>166,778</b>

**Consolidated Statements of Cash Flows**

	For the nine months ended		For the three months ended		For the
	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	year ended December 31 *2003 (Audited)
	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands
<b>Cash flows from operating activities:</b>					
Net earnings (loss)	39,126	(24,215)	10,271	(7,211)	(32,897)
Adjustments required to reconcile cash from operating activities (Annex A)	(178,159)	(51,314)	(35,856)	(22,188)	(52,432)
<b>Net cash inflow (outflow) attributed to continued operations</b>	<b>(139,033)</b>	<b>(75,529)</b>	<b>(25,585)</b>	<b>(29,399)</b>	<b>(85,329)</b>
Net cash outflow attributed to discontinued operations	-	12,758	-	(1,121)	14,983
Net cash outflow from operating activities	(139,033)	(62,771)	(25,585)	(30,520)	(70,346)
<b>Cash flows from investing activities:</b>					
Purchase of fixed assets, real estate and amounts charged to projects under construction and other assets	(75,365)	(101,289)	(20,636)	(10,108)	(108,278)
Proceeds from sale of fixed assets and other assets	172,093	18,003	68,464	7,092	24,735
Proceeds from sale of marketable securities, short-term investments and deposits, net	59,904	68,982	53,621	90,855	90,655
Investments in investee and other companies (including through loans and capital notes), net	(119,574)	(120,827)	(64,899)	(32,488)	(145,104)
Decrease in deposits and loans granted, net	(33,714)	18,735	(9,879)	10,116	22,058
Proceeds from sale of investment in investee and other companies	273,182	193,229	37,995	131,149	218,099
Initially fully or proportionately consolidated companies and acquisition of activities (Annex C)	(13,759)	-	-	-	33,724
Companies formerly fully or proportionately consolidated no longer consolidated and activities sold (Annex D)	-	29,865	-	29,865	29,865
Investment grant received	761	-	761	-	-
Dividend from subsidiary and others	-	314	-	-	795
Net cash inflow (outflow) attributed to continued investments activities	263,528	107,012	65,427	226,481	166,549
Net cash inflow attributed to discontinued investment activities	-	74,022	-	(4,811)	108,371
<b>Net cash inflow from investment activities</b>	<b>263,528</b>	<b>181,034</b>	<b>65,427</b>	<b>221,670</b>	<b>274,920</b>

\* Reclassified, including discontinued operations

\*\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

**Consolidated Statements of Cash Flows (cont'd)**

	For the nine months ended		For the three months ended		For the
	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	year ended December 31 *2003 (Audited)
	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands
<b>Cash flows from financing activities:</b>					
Purchase of Treasury shares	-	(106)	-	-	(106)
Sale of Treasury shares	1,861	-	-	-	-
Liability for financial lease	(56,026)	54,739	(56,026)	2,139	54,739
Issuance of debentures and convertible debentures in consolidated companies	-	35,845	-	-	35,845
Issue of convertible debentures in Company's shares	-	16,548	-	-	16,548
Repayment of convertible debentures in Company's shares	-	(4,890)	-	-	(4,890)
Dividend to minority	(22,292)	(269)	(643)	-	(3,221)
Receipt (repayment) of loans and capital notes, net	(147,590)	(2,436)	(37,321)	(47,389)	(64,171)
Issuance of marketable securities of consolidated companies	54,835	150	54,393	-	618
Purchase of shares from the minority shareholders by consolidated company	(844)	-	(393)	-	-
Repayment of short-term credit, net	11,001	(81,042)	(21,031)	(94,808)	(12,434)
Repayment of debentures and convertible debentures by consolidated companies	(12,382)	(51,808)	-	(24,007)	(96,228)
<b>Net cash inflow (outflow) attributed to continued financing activities</b>	<b>(171,437)</b>	<b>(33,269)</b>	<b>(61,021)</b>	<b>(164,065)</b>	<b>(73,300)</b>
Net cash outflow attributed to discontinued financing activities	-	(80,307)	-	6,495	(117,385)
<b>Net cash outflow from financing activities</b>	<b>(171,437)</b>	<b>(113,576)</b>	<b>(61,021)</b>	<b>(157,570)</b>	<b>(190,685)</b>
<b>Translation differences with respect to cash balances with respect to cash balances in autonomous investee companies</b>	<b>(1,145)</b>	<b>(946)</b>	<b>(900)</b>	<b>189</b>	<b>(999)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(48,087)</b>	<b>(2,732)</b>	<b>(22,079)</b>	<b>33,206</b>	<b>6,921</b>
<b>Balance of cash and cash equivalents at beginning of period</b>	<b>289,518</b>	<b>282,597</b>	<b>263,510</b>	<b>246,659</b>	<b>282,597</b>
<b>Balance of cash and cash equivalents at end of period</b>	<b>241,431</b>	<b>279,865</b>	<b>241,431</b>	<b>279,865</b>	<b>289,518</b>

\* Reclassified, including discontinued operations.

\*\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

**Consolidated Statements of Cash Flows (cont'd)****Annex A -****Adjustments required to reconcile cash from operating activities**

	For the nine months ended		For the three months ended		For the year ended
	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	September 30 2004 (Unaudited)	September 30 *2003 (Unaudited)	December 31 * 2003 (Audited)
	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Reported Amounts** NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands
<b>Income and expenses not involving cash flows:</b>					
Loss (gain) attributed to discontinued operations	-	9,494	-	342	9,729
Depreciation and amortization	<b>42,852</b>	56,401	<b>13,494</b>	19,592	68,922
Company's equity in losses (earnings) of investee companies less of dividend received, net	<b>(33,476)</b>	4,604	<b>(9,521)</b>	5,327	9,263
Minority interest in results of subsidiaries, net	<b>54,219</b>	(54,635)	<b>24,701</b>	(13,667)	(68,985)
Loss (gain) on marketable securities and deposits, net	<b>(2,772)</b>	(56,668)	<b>3,119</b>	(12,577)	(91,597)
Expenses (income) from financing activities	<b>13,019</b>	(4,832)	<b>1,638</b>	(3,163)	8,959
Deferred taxes, net	<b>9,199</b>	(3,888)	<b>4,650</b>	(3,274)	(10,170)
Increase (decrease) in liability for employee severance benefits, net	<b>533</b>	(764)	<b>1,324</b>	218	(3,259)
<b>Loss (gain) on sale and amortization of investments and assets, net</b>	<b>(162,224)</b>	(4,455)	<b>(72,947)</b>	(11,565)	(17,022)
Other expenses	<b>7,587</b>	-	<b>3,057</b>	-	17,839
<b>Changes in asset and liability items</b>					
<b>Decrease (increase) in trade receivables and other receivables</b>	<b>(68,544)</b>	1,363	<b>(21,091)</b>	20,005	(912)
Decrease (increase) in inventory and in land business inventory holdings, net	<b>20,224</b>	14,509	<b>83,543</b>	(1,467)	-
<b>Increase (decrease) in suppliers and service providers</b>	<b>(58,776)</b>	(12,443)	<b>(67,823)</b>	(21,959)	24,801
	<b>(178,159)</b>	(51,314)	<b>(35,856)</b>	(22,188)	(52,432)

\* Reclassified, including discontinued operations

\*\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

**Consolidated Statements of Cash Flows (cont'd)****Annex B - Non-cash transactions**

	For the nine months ended		For the three months ended		For the year ended
	September 30 2004 (Unaudited)	September 30 2003 (Unaudited)	September 30 2004 (Unaudited)	September 30 2003 (Unaudited)	December 31 2003 (Audited)
	Reported Amounts* NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Reported Amounts* NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands
Conversion of convertible debentures into Company shares	3,313	-	-	-	-
Purchase of Treasury stocks and option warrants in exchange of redemption of loans to employees in a subsidiary	-	-	-	-	25,552
Amounts receivable in respect of sale of short-term investments	-	-	-	-	870
Proceeds from sale of investment in investee	-	701	-	701	1,397
Purchase of fixed assets on credit	1,873	4,530	651	4,530	4,221
Investments in a subsidiary in respect of issuance of shares	-	36,575	-	-	36,575
Amounts receivable from sale of land, rental building and fixed assets on credit	2,653	-	-	-	76,028
Partial acquisition of consolidated company against the issuance of shares, options warrants and debentures to the minority	-	-	-	-	24,687
Investment in investee company by issuance of capital in a consolidated company	-	10,847	-	-	10,847
Dividend receivable from investee company	7,851	-	7,851	-	-
Commitment to invest in other companies	932	219	837	219	1,397

**Annex C - Initially fully or proportionately consolidated companies and acquisition of activities**

	For the nine months ended		For the three months ended		For the year ended
	September 30 2004 (Unaudited)	September 30 2003 (Unaudited)	September 30 2004 (Unaudited)	September 30 2003 (Unaudited)	December 31 2003 (Audited)
	Reported Amounts* NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Reported Amounts* NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands	Amounts adjusted to the effect of inflation in terms of NIS of December 2003 NIS thousands
<b>Assets and liabilities of the subsidiaries as at date of consolidation</b>					
Working capital, net (exclude cash and cash equivalents)	2,277	-	-	-	38,084
<b>Investments, long-term receivables and fixed assets, net</b>	(16,197)	-	-	-	(19,194)
Other assets and deferred expenses, net	(3,754)	-	-	-	(17,816)
Long-term liabilities	3,915	-	-	-	68,533
Investment in investee					

companies, net	-	-	-	-	1,580
Goodwill at acquisition date	-	-	-	-	(37,463)
	<u>(13,759)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>33,724</u>

\* In respect of discontinuance of adjustment for the effect of inflation according to the CPI of December 31, 2003.

**Consolidated Statements of Cash Flows (cont'd)****Annex D - Companies formerly fully or proportionately consolidated no longer consolidated and activities sold**

For the nine months ended		For the three months ended		For the year ended
September 30 2004 (Unaudited)	September 30 2003 (Unaudited)	September 30 2004 (Unaudited)	September 30 2003 (Unaudited)	December 31 2003 (Audited)
Reported Amounts*	Amounts adjusted to the effect of inflation in terms of NIS of December 2003	Reported Amounts*	Amounts adjusted to the effect of inflation in terms of NIS of December 2003	Amounts adjusted to the effect of inflation in terms of NIS of December 2003
NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands

***Assets and liabilities  
of***

**previously consolidated  
companies as at the date of  
their exit from the  
consolidation**

Working capital, net (excluding cash and cash equivalents)	-	42,482	-	42,482	42,482
Investment and long-term loans	-	1,366	-	1,366	1,366
Fixed and other assets, net	-	14,944	-	14,944	14,944
Long-term liabilities	-	(6,101)	-	(6,101)	(6,101)
Minority interest	-	(25,050)	-	(25,050)	(25,050)
Balance of loans and investments	-	(10,622)	-	(10,622)	(10,622)
Loss on sale of issuance to third party	-	12,846	-	12,846	12,846
	-	29,865	-	29,865	29,865