

## **Shrem, Fudim, Kelner and Co. Ltd.**

### **Directors' Report on the Company's State of Affairs As of June 30, 2006**

Pursuant to the Securities Regulations (Periodic and Immediate Reports"), 1970, the board of directors is pleased to submit the Directors' Report of Shrem. Fudim, Kelner and Co. Ltd. ("the Company") for the six and three-month periods ended June 30, 2006 ("the reporting period" and "the quarter", respectively), which also contains an update regarding significant changes and new developments that occurred in the Company's businesses in comparison with the Periodic Report of the Company for the year 2005. In this Report, the Company and its subsidiaries shall be called the Group.

#### **1. Condensed description of the corporation and its business environment**

The Company is a holding company; most of its activities are in the fields of the capital markets, industry, communications and technology, real estate and infrastructures, digital printing and trade and services.

**Capital Markets:** - The Company is engaged in the capital market, inter alia, through Leader Capital Markets Ltd., ("Leader Capital Markets"), which is engaged in providing management and underwriting services, in offerings of securities of companies interested in raising funds from the public, management of private placements, distribution of blocks of securities, brokerage services to investors, mainly to institutional investors, as well as investment in and trading of securities and financial instruments. At the end of February 2006, Leader Capital Markets published a prospectus to issue its shares to the public. See also paragraph 2.1.2 below. The Company also engages in this field through a subsidiary, Sphera Funds Management Ltd., which manages the Sphera Fund, a hedge fund for investment in marketable securities.

**Industry:** - Urdan and the companies it controls are engaged in industry and commerce, focusing on metals, complex products, construction and development products, construction finishing products, paints and insulation products.

**Communications and technology:** - The activities are carried out mainly through its directly and indirectly-held investee companies – Shrem Fudim Kelner Technologies Ltd. ("Technologies"), Telit Communications Plc, Cimatron Ltd., D.B.S. Satellite Services (1998) Ltd., and through its direct investments. At the end of February 2006, Technologies published a prospectus for the issuance of debentures and options to the public. See also Paragraph 2.3.4 below.

**Real Estate and Infrastructures** – The Company operates through directly and indirectly held investees – Leader Real Estate (2006) Ltd., Polar Real Estate Ltd., Ofir Holdings Ltd., and Sitips Ltd.

**Digital Printing** - The digital printing segment includes the activities of Nipson Digital Printing Systems PLC and its investee companies.

**Trade and Services** – The activities are carried out mainly through its directly and indirectly-held investees, Hazera (1939) Ltd., Reshet – Noga Ltd., and other companies that consolidate automotive activity in Eastern Europe.

The Company is engaged, directly and through its investee companies, in the acquisition, establishment, improvement and business development of operations and companies in the aforementioned fields. In addition, the Company is engaged in, among other things, consulting and management services to its investee companies, in hedge fund management, as described above, providing consultancy and management services in the field of investment banking and for several venture capital funds.

During the reporting period, by exercising its rights, Leader purchased from Polar Investments shares and option warrants of Polar Communications offered by prospectus to the shareholders of Polar Investments.

As a result of the above, and in view of additional purchases of shares of Polar Communications during and sequent to the reporting period, Leader directly holds 46.5% of the issued and paid in capital of Polar Communications. See also paragraph 2.7.3 below.

The Company ended the reporting period with net income of NIS 2.3 million, compared with net income of NIS 55.0 million in the same period last year.

In April 2006, the Company and Leader each distributed a cash dividend of NIS 15 million. Additionally, Polar Communications, Urdan, and Leader Capital Markets distributed dividends of NIS 50 million, NIS 10 million, and NIS 4.4 million respectively. Subsequent to the balance sheet date, Leader Capital Markets declared an additional dividend of NIS 8 million.

## **2. Noteworthy events during the reporting period until proximate to the publication date of this Report, broken down by the Company's operating segments**

### **2.1 Capital market segment**

- 2.1.1 The Sphera Fund is a fund for investments in marketable securities which, as of the publication date of this Report, totaled \$130 million. Sphera is managed by a corporation that is controlled by the Company, and by other managers.

The Sphera Fund ended the reporting period with income of US\$ 2.2 million and a loss for the quarter in an immaterial amount (in view of the decline in the exchange rate of the U.S. dollar, the Sphera Fund lost an amount of NIS 11.1 million during the reporting period and an amount of NIS 29.6 million during the quarter). The net dollar yield in the fund in the reporting period was 2.1%, compared with a 0% yield of the Tel-Aviv 100 Index (in dollar terms) and a decrease in the Nasdaq of 1.5%. The net dollar yield of the fund in the years 2005 and 2004 was 16.1% and 28%, respectively. The aforementioned shekel loss derived from the revaluation of the assets of the Fund which was due mainly to the 3.5% and 4.8% decline in the dollar exchange rate during the reporting period and in the second quarter, respectively.

- 2.1.2 In the reporting period, Leader's board of directors resolved to consolidate the Group's capital market activities under a new company that was incorporated on January 3, 2006 – Leader Capital Markets. This subsidiary was founded for the purpose of holding Leader & Co. Investment House Ltd. and Leader Issuances (1993) Ltd., subsidiaries of Leader engaged in the capital market sector.

In February 2006, Leader Capital Markets issued a prospectus for an initial public offering of its securities ("the prospectus"). Under the terms of the prospectus, Leader Capital Markets offered to the public 2,170,000 ordinary shares, NIS 0.01 par value. The offering pursuant to the prospectus closed on March 7, 2006, and the offering proceeds totaled NIS 33 million (before issuance costs).

As a result of this offering, the Company's share in Leader Capital Markets fell to 66%, and in its financial statements for the first quarter of 2006, it recorded a gain from the decline in shareholding percentage of NIS 20 million (the Company's share – NIS 12 million).

- 2.1.3 During the reporting period, a subsidiary of Leader Capital Markets paid the sum of \$2 million to Yelin-Lapidot and to Yair Lapidot, in consideration for the transfer and allotment of shares of Yelin-Lapidot that constitute 30% of its capital ("the acquired shares"), and receipt of an option to increase its holdings to up to 50% of the capital of Yelin-Lapidot.

On May 31, 2006, the first phase of the agreement to purchase the Yellin-Lapidot shares was consummated by the subsidiary of Leader Capital Markets, after written approval was obtained from the Commissioner of the Capital Markets, Insurance and Savings of the Finance Ministry to control and hold means of control in Yellin-Lapidot Provident Funds Ltd. (Yellin-Lapidot Provident"), a wholly-owned subsidiary of Yellin-Lapidot.

Yelin-Lapidot currently manages NIS 3 billion in assets.

During the reporting period, Leader Capital Markets distributed a dividend of NIS 4.4 million. Subsequent to the balance sheet date, Leader Capital Markets declared an additional dividend of NIS 8 million.

## **2.2 Real estate and infrastructure segment**

- 2.2.1 During the reporting period, Leader, through its wholly-owned subsidiary ("Leader Real Estate") signed a framework agreement with a third party ("the Partner") to acquire various parts of rental apartment projects in Germany for a total amount of €150 million. Leader's indirect share in the venture is 32.5%. The total investment of Leader Real Estate amounts to 4.5% of the venture.

Additionally, an agreement was signed with a foreign financial institution, which is financing up to 90% of the transaction.

Pursuant to the agreement, the parties to the transaction were given six months to close the acquisition of residential properties at the said purchase price (including various acquisition costs) of €150 million. In the first stage, immediately after the signing of the financing agreement, the parties closed on the purchase of residential properties containing 1,500 housing units, at a purchase price (including various acquisition costs) of €50 million. Moreover, as of the publication date of the financial statements, additional agreements were signed for the purchase of residential properties containing 1,700 housing units and 30 stores for an amount of €65 million. Payment for these properties has not yet been made. Upon the signing of a financing agreement for the purchase of these properties, the bank will approve an extension of four to six months for the gathering of properties up to a total amount of €150 million.

The aforementioned residential properties are rented out at an occupancy rate of more than 90%.

The share of Leader Real Estate in the above financing amounted to €2.4 million as of the publication date of the financial statements.

- 2.2.2 During the reporting period, Leader, through Leader Real Estate, signed a framework agreement with a third party ("the Partner") to acquire commercial rental real estate projects in Germany totaling up to €120 million. The indirect share of Leader Real Estate in the venture is 47.5%. The total investment of Leader Real Estate amounted to 4.7% of the venture.

Additionally, an agreement was signed with a foreign financial institution, which is supposed to make financing available to the venture at the rate of 90%. Supplementary financing at the rate of 3% of the transaction was made available to the venture by a partnership that is jointly managed by two corporations, one of which is controlled by the Company ("the Partnership").

Pursuant to the agreement, the parties to the transaction were given six months to close the acquisition of commercial properties at the said purchase price (including various acquisition costs) of €120 million. In the first stage, immediately following the signing of the financing agreement, the parties closed on the purchase of ten commercial properties, which contain shopping centers and supermarkets, at a purchase price (including various acquisition costs) of €40 million. In May 2006, the parties closed on another purchase of five additional commercial properties (mainly supermarkets) at a total cost of €20 million. In July 2006, the parties consummated the acquisition of another seven properties at a total cost of €24 million.

Moreover, agreements were signed to purchase five additional properties at a total cost of €24 million, although the execution of the agreements is not yet complete.

The aforementioned commercial properties are rented out at an occupancy rate of 98%.

The share of Leader Real Estate in the above financing amounted to €3.8 million as of the publication date of the financial statements. Moreover, the Partnership provided supplementary financing of €3.4 million, representing its complete obligation relative to the maximum amount of the transaction.

- 2.2.3 Leader Real Estate applied to a foreign bank to finance the purchase of the Postal Building in Berlin that was acquired at the end of 2005. As of the date of the publication of the financial statements, a subsidiary of Leader Real Estate signed a financing agreement with a foreign bank in an amount of €17.4 million. Receipt of the loan is expected to be finalized in the near future.
- 2.2.4 On August 19, 2006, a foreign subsidiary of Leader (the "Subsidiary") signed an agreement with an unaffiliated third party for the purchase of half of the share capital of a number of foreign companies which either own real estate or are parties to agreements for the purchase of real estate in Croatia (the "Properties"). The Properties are in various stages of planning and construction, with some of them in the stage of obtaining building rights. Some of the real estate is earmarked for residential construction (650 units) and some is designated for commercial and hotel use. All of the real estate is located on the Istria Peninsula in Croatia.

In consideration of the shares, the subsidiary will pay an amount of €7.1 million, of which €4.6 million will be paid immediately, with the balance to be deposited in trust and paid upon fulfillment of a number of conditions in connection with one of the properties. An amount of €2 million of the aforementioned consideration will be financed by a limited partnership in which the limited partners are third parties and the general partner is a company under the control of a controlling shareholder of the Company. The balance will be financed by the Company's normal methods of finance, including bank financing.

Consummation of the acquisition of the properties owned by the foreign companies is contingent upon the payment of an additional amount of €9.5 million, which the Company believes will be financed through loans to be obtained from foreign banks (in the event that the loans are not forthcoming, half of the amount will be financed by the subsidiary and half will be financed by the third party with which the subsidiary contracted – the other shareholder in the foreign companies). The Company intends on having the projects partially financed by bank financing to be furnished by foreign financial institutions and partially from the proceeds of the project sales. See also Note 3.B.5 of the financial statements.

- 2.2.5 Further to the periodic report of 2005, we would like to make note of the fact that in April 2006, Polar International consummated the acquisition of land in the U.K. through a British partnership ("Partnership") in which it is a partner together with third parties. The consideration for the acquisition was an amount of £4.5 million.

- 2.2.6 The Partnership intends on constructing a building which will contain storage and office space, at an estimated total cost of £8.5 million. Upon completion of the construction, the Company plans on selling the building in its entirety or broken down into units.

Polar International holds 33% of the rights in the partnership and undertook to invest an amount of £1.5 million in the shareholders' equity of the partnership. Upon the consummation of the purchase of the land, Polar International transferred an amount of £1.2 million on account of the shareholders' equity.

- 2.2.7 Further to Note 3.B.3.(a) of the annual financial statements as of December 31, 2005, in connection with the acquisition of "Harold Tower" (the "Building"), the seller notified the Corporation on March 21, 2006 that it had withdrawn its notice of breach of contract and its cancellation notification and that the purchase agreement was in effect.

Concurrently and at the same time, the Corporation received two new notices of breach of the purchase agreement. The Corporation corrected the alleged violations on time.

As part of the purchase agreement, it was stipulated that in order to conduct the closing of the purchase of the building by the stipulated date (June 12, 2006), the Corporation would have to present to the seller, at least 60 days prior to the closing date, a confirmation from the Attorney General that the conversion process had been completed. As of the required date, the Corporation had not obtained the said confirmation from the legal department of the Attorney General.

In view of the above, on April 18, 2006, the Corporation received from the seller notification of the cancellation of the purchase agreement and a demand to seize the advance payment made on account of the purchase and funds drawn in respect thereof. Further to the seller's notification, the Corporation notified the trustee that it objected to the transfer of the balance of the advance to the seller. Moreover, on April 23, 2006, the Corporation commenced a process of obtaining judicial relief in New York State regarding the changing of the date of the closing as stipulated in the agreement, requesting that the court stipulate that the closing of the building be conducted within 60 days from the date that the Corporation actually obtains the confirmation of the Attorney General that the conversion process was completed. Among the reasons for its request, the Corporation claimed that the intentional actions of the seller were the cause for the failure to obtain the confirmation on time. On July 20, 2006, a hearing was held at which the judge rejected both the request of the seller to have the purchase agreement voided and the request of the Corporation to have the court find that it was the seller who prevented the Corporation from fulfilling its obligations under the agreement. The next hearing was set for October 4, 2006, at which the court will deliberate, among other things, whether the Corporation was in breach of the agreement and whether the seller prevented the Corporation from fulfilling its commitments under the purchase agreement.

Pursuant to the dispute between the Corporation and the seller, and in view of the sales agreements signed with 140 apartment purchasers as of March 31, 2006, the prospectus submitted by the Corporation in order to obtain the confirmation of the conversion of the building was amended, thereby granting those apartment purchasers who paid the entire advance the right to cancel the purchase agreement by May 15, 2006. As of the stipulated date, 80 apartment purchasers exercised this right. Notwithstanding, since that date, the Corporation signed 120 agreements for the sale of new apartments. Those agreements were submitted to the Attorney General together with the sales agreements that had not been cancelled, in order to obtain his confirmation that the Corporation was in compliance with the conversion procedure.

In the opinion of the management of Polar International, based on the assessment of the management of the Corporation, the chances that the building acquisition transaction will be consummated are reasonably high. Notwithstanding, even if the transaction is not consummated, there will be no material effect on the results of operations of Polar International.

2.2.8 During the reporting period, Polar International expanded its operations, as follows:

1. It participated in the "Hard Rock Park" project in the U.S., together with a number of partners (most of whom are locals), including the signing of a project financing agreement in an amount of US\$ 305 million.
2. It signed a memorandum of understanding to set up a joint venture in China to deal in initiation, development and construction of a real estate project in the Jewish quarter of Shanghai. The initial cost budget was estimated at US\$ 700 million.

See also Note 3.B.3.(a) of the financial statements.

2.2.9 In August 2006, Erco Holdings Ltd. (formerly Leader Tech Ltd.) ("Erco Holdings") published a prospectus for the issuance of debentures and options of Erco Holdings. The immediate gross proceeds of the issuance are NIS 47 – 50 million.

A subsidiary of Leader Capital Markets is the consortium manager on this issuance.

For more information regarding material real estate transaction in which Erco Holdings was involved, see Note 3.B.6 of the financial statements.

## **2.3 Telecommunications and technology segment**

- 2.3.1 In the reporting period, the Company and Technologies, after receiving the approval of the general meeting of Technologies, acquired all of the holdings of the Japanese trading company Marubeni Corporation ("Marubeni") in Technologies, which constituted, as of the date of sale, 16.8% of the voting rights in Technologies, in consideration for \$2.5 million, reflecting a share price of \$0.392 per share ("sale of Marubeni shares".)

In February 2006, as part of the sale of Marubeni shares, Technologies acquired a total of 4,760,000 ordinary shares, NIS 0.01 par value each, of Technologies, in consideration for \$1.9 million (NIS 8.8 million). This acquisition was part of the balance (which stood at NIS 8.9 million before the acquisition) available to be bought back, in accordance with the ruling of the Tel Aviv District Court, which approved the permitted distribution of up to NIS 10 million.

The shares acquired by Technologies became dormant shares. The Company acquired the balance of the Technologies shares owned by Marubeni, i.e. 1,617,494 ordinary shares, NIS 0.1 par value each, in consideration for \$0.6 million (NIS 3 million).

During the reporting period, Technologies sold off-exchange 500,000 par value ordinary shares of Technologies for a total consideration of NIS 949 thousand. Following these transactions, the Company's holdings in Technologies rose to 75% of its capital.

Upon the closing of the sale of Marubeni shares, all of the Marubeni rights that had been conferred on Marubeni pursuant to the March 2002 agreement, including with respect to shares, as well as the right to appoint a director on behalf of Marubeni and including Marubeni's commitment to distribute dividends, lapsed.

- 2.3.2 During the last quarter of 2005, Technologies adopted a new strategy which was essentially to vary and expand its investment activity, so that commencing in 2006, Technologies would engage in a new field of activity – Private Equity. This activity is intended to include mainly investments in corporations operating in various fields, which are all characterized as suffering from financial or operational problems or some other special circumstances that cause them to be undervalued. In the opinion of Technologies, these companies have potential for high growth or good chances of recovery that will enable them to be sold at a later date for a good return on investment. Based on the above, Technologies set up, among other things, an investment fund under the joint control of Technologies (hereinafter – "Art P.A.") to engage in Private Equity activity. In June 2006, the investment of Art P.A. in Superior Cables Ltd. was consummated – see Note 3.A.10 to the financial statements.

- 2.3.3 On December 7, 2005, the board of directors of Technologies resolved to allot, in a private placement, NIS 18,000,000 par value of debentures (Series B), which are convertible into up to 8,571,429 ordinary shares of Technologies, in consideration for their par value, and 8,300,000 options (Series 1) without consideration, which may be exercised for ordinary shares of Technologies.

The debentures and options were allotted in April 2006. Also see Note 3.A.2 to the financial statements.

- 2.3.4 In March 2006, Technologies issued securities pursuant to a prospectus for a public offering as detailed in Note 3.A.2. to the financial statements, for a total amount of NIS 50 million

Out of the total proceeds of NIS 50 million from the public offering, Technologies allocated NIS 4 million, net, after deducting issuance costs, as receipts on account of options, based on the prices of the options and debentures during the first three trading days on the Tel Aviv Stock Exchange. See also Note 3.A.3 to the financial statements. The proceeds of this offering are earmarked, inter alia, to private equity investments, as described previously.

- 2.3.5 During the quarter, further to arrangements reached by the Pitango Fund with some of the investors, DS Polaris Ltd. (a subsidiary of Technologies) recorded revenues in respect of the cancellation of the reserve for success fees it had previously recorded, in an amount of NIS 8.9 million. The impact of the above on the results of operations of Technologies for the reporting period was a net income of NIS 3.4 million (the share of the Company – NIS 2.6 million).

- 2.3.6 Subsequent to the balance sheet date, Technologies and the Platinum Fund (a venture capital fund jointly controlled by Technologies) completed the sale of their holdings in ADT (an affiliated company). As a result of the sale, Technologies expects to record a capital gain in the third quarter of the year, including in respect of its share as a limited partner in the Platinum Fund, in an amount of NIS 4.6 million (the share of the Company – NIS 3.5 million). See also Note 3.A.11 to the financial statements.

- 2.3.7 In March 2006, Polar Communications Ltd. ("Polar Communications") sold of all of its holdings in the share capital of Partner to Elron Electronic Industries Ltd. for NIS 25 million. As a result of the closing of the sale, Polar Investments Ltd. posted a pre-tax gain in the first quarter of NIS 20 million (the Company's share is NIS 5.5 million).

2.3.8 The Company and companies under its control undertook to invest in Tenne, the Fund for Investment in Kibbutz Enterprises amounts of \$0.5 million and \$2.5 million, respectively. During 2005, the Company and companies under its control invested in Tenne NIS 0.3 million and NIS 1.8 million, respectively. During and subsequent to the reporting period, the Company and companies under its control invested in Tenne additional amounts of NIS 1.2 million and NIS 6.2 million, respectively.

In addition, Leader owns 3% of the general partner of the Fund.

2.3.9 Further to the description in the Immediate Report for the year 2005, regarding arbitration proceedings between YES and Play TV Ltd., producer of the "Playboy" and "Adult" channels ("Play TV"), in connection with an arbitrator's ruling and the request for a clarification, the parties reached a compromise agreement whereby all the proceedings that had been conducted between them, covered by the arbitrator's ruling, were concluded. Pursuant to the compromise agreement, YES is entitled to receive a certain sum from Play TV.

In addition, further to the description in the Periodic Report for the year 2005 regarding the Andamol claim, please note that the parties reached an agreement in principle on a compromise to end the dispute. A binding agreement has not yet been drafted, whereby the claim will be withdrawn, and YES will pay \$180 thousand to Andamol (including for the purchase of certain content from Andamol).

Moreover, further to the description in the Periodic Report for the year 2005, in June 2006, a petition was filed with the Tel Aviv District Court to approve a class action suit against YES and against the cable companies, in connection with the broadcasting of commercials during the transmission of the "Mondial" ("Request for Approval"). According to the plaintiffs, the commercials that were incorporated into the first three days of broadcasting of the Mondial Channel as part of the games and the Mondial studio, were allegedly illegal, in violation of the contract between YES and its customers and in violation of the conditions set forth in the resolution of the Council for the Approval of the Broadcast of the 2006 Mondial Games. The petitioners estimated the amount of the suit at NIS 530 per subscriber to the Mondial package, for a total amount of NIS 106 million in respect of all of the members of the group (based on 200,000 subscribers to the Mondial package marketed by the cable companies and YES together). The petitioners requested to sue YES on the basis of the Class Action Law – 2006, claiming misrepresentation, breach of legislated obligations, obtaining wealth not by right, and a breach of a contractual obligation, in respect of three torts: decline in value of the Mondial package, infringement of autonomy, and causing anguish. YES's response to the request to have the suit approved as a class action is scheduled to be submitted to the court by September 15, 2006. Based on its legal counsel, at this stage, YES is unable to assess the chances of the suit.

2.3.10 In May 2006, Polar Communications indirectly purchased 6% of the share capital of Medi wound Ltd. ("Medi wound") for an amount of NIS 9 million. Medi wound developed a pharmaceutical for the treatment of severe burns. The drug is currently in an advanced stage of clinical trials with humans.

## **2.4 Trade and services segment**

- 2.4.1 In January 2006, Polar Communications (through its wholly-owned subsidiary) signed an agreement ("the Agreement") for the sale of 6% of the share capital and voting rights in Reshet, to a third party that also purchased an additional 14% of the shares from another shareholder in Reshet, for total proceeds of \$2 million.

In June 2006, the transaction was closed, pursuant to which Polar Communications holds, indirectly, 30% of the share capital and voting rights in Reshet. Consequently, Polar posted a pre-tax gain of NIS 6 million (the Company's share is NIS 1.2 million) in the second quarter.

- 2.4.2 In June 2006, Telit consummated the purchase of 75% of the share capital of Bellwave M2M Co. Ltd. ("Bellwave") for a cash amount of \$6.18 million. As part of the transaction, Telit was granted an option to purchase the balance of the share capital of Bellwave (25%) for an amount of \$2 million, by December 2006. Bellwave is a subsidiary of the South Korean company, Bellwave Co. Ltd., which deals with intersystem communications (M2M). M2M communications are wireless computerized communications between remote systems and an operations center or directly between remote systems, providing real-time supervision and control with no need for human intervention. Bellwave developed the world's smallest CDMA module for data communications and will focus upon development of products in this area. Bellwave is also expected to assist in the penetration of Telit's products to the Asian – Pacific market.
- 2.4.3 In April and June 2006, Polar Investments sold all of its (indirect) holdings in Dor Chemicals for an amount of NIS 29 million. As a result, Polar Investments posted a pre-tax gain of NIS 6 million in the second quarter (the share of the Company – NIS 1.7 million).

## **2.5 Industrial segment**

- 2.5.1 On May 14, 2006, a compromise agreement ("the Compromise Agreement") was signed between the plaintiffs and defendants, including a subsidiary of Urdan – H. Aloni ("Aloni") Industries Ltd., in connection with a claim that was filed in the past for restrictive business practices ("the Claim").

On the date it was signed, the parties submitted the Compromise Agreement for approval to the District Court, which has not yet ruled on the matter. Pursuant to the Compromise Agreement, each of the represented plaintiffs may receive from the defendants (which are active companies), when future purchases are made from the defendants, a credit of 40% or 60% of the full list price (suggested retail price) of these defendants, if evidence was brought that it had purchased tiles from that defendant or other specific entities stipulated in this agreement, during the relevant period, 1995-1997, as stipulated in the Compromise Agreement. For

additional details on the Compromise Agreement, see Note 3.B.4.a. to the financial statements.

In view of the aforesaid, the financial statements of Aloni include a provision of NIS 0.7 million, for its share of the Compromise Agreement.

- 2.5.2 During the second quarter, the affiliate, E.E.R. Environmental and Energy Resources (Israel) Ltd. ("EER") offered to its existing shareholders (including the Company), to participate in a capital offering of up to \$10 million ("planned offering") at a company value for EER of \$65 million (before the investment).

Since the planned offering has not yet been closed, EER decided to approach a banking institution to obtain interim financing of \$1 million ("bank financing").

To secure the bank financing, Urdan, the Company and Technologies furnished guarantees of \$630 thousand, \$280 thousand and \$90 thousand, respectively, on a pro rata basis between them, according to the ratio of their holdings in the share capital of EER. Subsequent to the balance sheet date, EER repaid approximately NIS 0.5 million of this bank financing.

Furthermore, it was agreed (in effect until December 2006) between EER and a Japanese investor which is a shareholder in EER, that if the share of the Japanese investor in the planned offering is between \$5 and \$10 million dollars, then EER will transfer to the Japanese investor, without additional consideration, shares of the subsidiary of EER in Japan (the "Japanese Company") that constitute 17% of the voting rights and 5% of the rights in share capital of the Japanese company, so that after their transfer, the Japanese investor will hold 67% of the voting rights in the Japanese company and 55% of the rights in the share capital of the Japanese company. In this framework, it was also stipulated that the Japanese company will be responsible for marketing the Company's products in Singapore, and will receive a license to distribute EER's products in Singapore (under conditions similar to the license that was given to the Japanese company for Japan). As of the date of this Report, the marketing activities for the EER products in Japan and/or Singapore have not yet begun. This agreement has not yet been ratified by all of the shareholders of EER.

Moreover, EER approached its shareholders that participated in the last round of capital raised in September 2005 for a total of \$3.1 million (of which \$1.0 million was invested in 2006), through shareholder loans together with options exercisable for share capital of EER (at a company value for EER of \$80 million), with a request that these shareholder loans be converted to share capital of EER, within the framework of the planned offering (i.e. at a company value for EER of \$65 million) and that the above options should expire.

Under the terms of the last round of capital raised by EER, as aforesaid, the participation of Urdan was \$0.95 million, and the participation of the Company and Technologies was \$0.4 million and \$0.15 million, respectively.

Subsequent to the balance sheet date, one of the shareholders of EER invested an additional \$0.5 million in return for 0.8% of the latest share capital. In addition, all of the shareholders that participated in the latest round of fundraising (including the Company) responded to EER's call as described above. In view of the above, the share of the Company, Urdan, and Technologies in the share capital of EER is 7.5%, 18%, and 3.0% respectively.

There is no certainty that the planned offering will be executed in full, what its complete terms will be and what the share of each of the shareholders in EER (including the Company) will be within the framework of this offering.

For additional details, also see Note 3.C to the financial statements.

- 2.5.3 During the reporting period, Orlight entered into an agreement with Anbar Reinforced Polyester Ltd. (Anbar), a company privately owned by Kibbutz Hamadia (currently under the Israeli equivalent of Chapter 11 protection; hereinafter – the "Kibbutz"), which is not an interested party and which is engaged at its plant on the Kibbutz (hereinafter – the "Plant") in the manufacture and marketing of reinforced polyester products, including closets, switching boxes, insulation boards, lighting fixtures, and heating products.

Under the agreement, Orlight will purchase from Anbar its major operations, including its machinery and equipment, inventories, intellectual property, goodwill, etc. (the "Sold Assets and Operations"), for a total amount of NIS 14 million (linked to the Israeli Consumer Price Index - ICPI, plus VAT), plus an additional payment for the value of inventories to be transferred to Orlight upon the closing of the transaction. The amount of the additional payment will be set by the parties proximate to the closing date and will be paid out over a six month period subsequent to that date.

Out of the consideration for the Sold Assets and Operations, an amount of NIS 2 million will be paid at the closing, and the balance will be paid out in equal installments over a period ending in 2013 (linked to the ICPI, plus interest at a rate of up to 4.5% per annum).

As part of the agreement, Orlight did not assume any liabilities toward any third party in connection with the assets and operations which it bought, during the period up to the closing date. In addition, Orlight did not assume any liabilities that are based on products or services supplied by Anbar up to the aforementioned date.

In addition, upon the closing of the transaction and as a part thereof, an authorization agreement will be signed, granting Orlight authorization to use the property of the Plant located in the Kibbutz and which is leased from the Israel Lands Administration, in order to manage and operate the Assets and Operations sold to Orlight, as above. This authorization is for a five-year period, during which time Orlight will pay Anbar annual authorization fees of \$84 thousand. Moreover, Orlight will receive an option to extend the authorization period for three additional 12-month periods each, during which time Orlight will pay annual authorization fees of \$96 thousand.

The consummation of the agreement is contingent upon the fulfillment of a number of pre-conditions, as described in Note 3.B.4.g to the financial statements.

The closing date of the transaction will fall within 10 business days after the fulfillment of the last pre-condition. In the event that the pre-conditions are not fulfilled by December 31, 2006, the agreement will expire, with neither of the parties having any claims whatsoever toward the other party, unless they agree to extend the closing date.

As part of the agreement, Anbar and the Kibbutz undertook not to compete with Orlight in the field of the operations sold under the agreement, in any form whatsoever, during the four-year period following the closing date of the transaction.

- 2.5.4 During the reporting period, Urdan and one of its wholly-owned subsidiaries reached a court-approved compromise agreement with a third party, whereby the agreement covering the rental of property owned by Urdan and the subsidiary to the third party was extended until the end of 2008 (the original agreement expired in January 2005). The third party was granted an option to extend the rental period for an additional year and Urdan and the subsidiary were granted the right to shorten the period under certain circumstances. As part of the agreement, the annual rental fees were increased to NIS 1.7 million and it was stipulated that the third party would pay rental fee differentials of NIS 1.2 million in respect of the year and a half period that ended on June 30, 2006. This amount was reported in the second quarter of the year as "Other Income".

## **2.6 Additional events**

- 2.6.1 Mr. Itschak Shrem, Chairman of the Board of Directors, provides the Company with management services through a company he controls ("Shrem Company"). Under the terms of the agreement with it, Shrem Company is entitled to an annual bonus that is computed based on the pre-tax adjusted income (on a consolidated basis) plus the Company's share in the results of affiliates ("the representative income"). Shrem Company informed the Company that:
- A. Beginning from the year 2006 and thereafter, the annual bonus will be reduced to 5% (instead of 7.5%) of representative income.
  - B. Additionally, the bonus will be subject to a "high water mark", so that income for the purpose of the annual bonus will be on a cumulative basis. If in a certain year, beginning from 2006, the Company ends the year with a loss, the amount of the loss will be deducted from the representative income that was earned by the Company in the years subsequent to the year in which the loss was sustained. See note 4.B to the financial statements.

2.6.2 Mr. Yair Fudim, the director and CEO of the Company, provides the Company with management services through a company under his control ("Fudim Company"). Under the terms of the agreement with it, Fudim Company is entitled to an annual bonus that is computed based on the pre-tax adjusted income (on a consolidated basis) plus the Company's share in the results of affiliates ("the representative income"). Fudim Company notified the Company as follows:

- A. Beginning from 2006 and thereafter, the annual bonus will be reduced to 2% (instead of 2.5%) of the representative income.
- B. Additionally, the bonus will be subject to a "high water mark", so that income for the purpose of the annual bonus will be on a cumulative basis. If in a certain year, beginning from 2006 and thereafter, the Company ends the year with a loss, the amount of the loss will be deducted from the representative income that is earned by the Company in the years subsequent to the year in which the loss was sustained.

In addition, Mr. Yair Fudim, the director and CEO of Leader, provides Leader with management services through Fudim Company. Under the terms of the agreement with it, Fudim Company is entitled to an annual bonus that is computed based on the pre-tax adjusted income (on a consolidated basis) plus the Company's share in the results of affiliates ("the representative income"). Fudim Company notified Leader that, commencing from 2006 and thereafter, the annual bonus will be subject to a "high water mark", so that income for the purpose of the annual bonus will be on a cumulative basis. If in a certain year, beginning from 2006 and thereafter, Leader ends the year with a loss, the amount of the loss will be deducted from the representative income that is earned by Leader in the years subsequent to the year in which the loss was sustained. See Note 4.C to the financial statements.

2.6.3 On April 6, 2006, the board of directors of Polar Communications and the board of directors of Polar Investments authorized the filing of a draft prospectus with the Israeli Securities Authority and the Tel Aviv Stock Exchange Ltd. ("TASE"), based on the financial statements of Polar Communications as of December 31, 2005 ("the prospectus").

The approval was given by the board of directors of Polar Investments, inter alia, based on the Fairness Opinion of Professor Amir Barnea, which states, inter alia, that the process of the sale of the shares of Polar Communications held by Polar Investments, to its shareholders, is justified from an economic standpoint and fair from the standpoint of the shareholders.

Under the terms of the prospectus published on May 29, 2005, Polar Investments offered 18,695,820 ordinary shares, par value NIS 0.1, of Polar Communications, 2,157,210 option warrants (Series 2) of Polar Communications, and 4,170,606 option warrants (Series 4) of Polar Communications, in a sales offer by way of rights to its shareholders (hereinafter – the "Sales Offer"), in return for a total amount of NIS 142 million.

Under the terms of the prospectus, Polar Communications offered, by way of rights to its shareholders and holders of its option warrants (Series 2), for no consideration, 5,389,252 option warrants (Series 4), convertible into ordinary shares of Polar Communications, par value NIS 0.1 (the "Option Warrants (Series 4)"). On June 14, the Option Warrants (Series 4) were allotted by Polar Communications and listed for trade on the Tel Aviv Stock Exchange.

On June 29, 2006, Leader purchased from Polar Investment, by way of rights through a sales offer, the maximum amount of securities offered for a total amount of NIS 140 million. Under the terms of the underwriting agreement, the balance of the offered securities were purchased by the underwriters for an amount of NIS 2 million (a subsidiary of Leader Capital Markets served as the consortium manager of this issuance).

The value of the marketable securities of Polar Communications on the books of Polar Investments, less the net proceeds received as above, was presented as a dividend in kind in an amount of NIS 76 million.

In May 2005, the board of directors of Leader approved Leader's participation in the aforementioned offer, at an amount of NIS 70 million, based on Leader's relative holdings in Polar Investments. At a later date, the board of directors of Leader approved an additional investment in Polar Communications, so that the total investment of Leader in Polar Communications during and after the reporting period amounted to NIS 82 million. Following the consummation of the issuance of rights, as above, Polar Investments ceased being the parent company of Polar Communications, whereas Leader now directly holds Polar Communications.

As a result of the above, and as a result of additional shares of Polar Communications, during and after the reporting period, Leader effectively holds 46.5% of the issued and paid in share capital of Polar Communications. The book value of Polar Communications on the books of Leader totaled NIS 120 million as of the balance sheet date. Leader has been taking steps to obtain bank financing for this acquisition.

- 2.6.4 Regarding the conversions of debentures and exercise of Leader's options in Urdan during the reporting period and until the publication date of this report, see Note 3.B.4 to the financial statements.

In the reporting period, Leader sold 1,490 thousand shares of Urdan for NIS 4.5 million.

As a result of the aforesaid, the Company's share in Urdan decreased as of the publication date of this Report, to 47%.

- 2.6.5 In the reporting period, an investor who is not an interested party in Leader converted NIS 700,000 par value of Series C debentures into 91,600 ordinary shares of Leader. In addition, an interested party in Leader converted 4,650,000 par value debentures (Series B) into 608,487 ordinary shares of Leader. Following these conversions, the balance of Series B and C convertible debentures amount to 9,560,000 par value as of the Report date.

In the reporting period, an interested party in Leader exercised 500,000 Series I options into 500,000 ordinary shares of Leader, in consideration for NIS 2 million.

During the reporting period, 380,000 options (Series J) were exercised into 206,965 ordinary shares of the Company.

The effective shareholding rate of the Company in Leader after the above conversions is 56.7%.

- 2.6.6 In May 2006, the Company signed an agreement with Silberbaum Holdings Ltd. ("Silberbaum"), whereby it will sell all of its holdings in this company to Silberbaum for consideration of NIS 1 million to be paid in cash, as well as NIS 4.4 million to be paid in four equal annual installments (bearing interest and linkage differences), beginning May 18, 2007. Additionally, Silberbaum will transfer to the Company one million shares of World Group Holdings Ltd., which is traded on the stock exchange, as well as all of its holdings in two funds managed by Technologies. As a result of the aforementioned sale, the Company posted a gain of NIS 3.6 million in the Quarter.

### 3. Financial position

The following table presents data from the consolidated and balance sheet and the balance sheet of the Company and the private companies it controls (\*) in reported NIS millions of June 2006:

|  | As of June 30, 2006        |                       |  | As of December 31, 2005  |
|--|----------------------------|-----------------------|--|--|
|  | Consolidated balance sheet | Company balance sheet | Balance sheet of the Company and private companies it controls (*) | Balance sheet of the Company and private companies it controls (*) |
| Current assets   | 2,073.0                    | 106.6                 | 105.5  | 145.7  |
| Investments and loans in investee (affiliated) and other companies | 817.3                      | 330.7                 | 299.3  | 296.7  |
| Real property  | 538.6                      | -                     | -  | -  |
| Fixed assets   | 600.8                      | 23.1                  | 24.5   | 25.2   |
| Other assets and deferred expenses                                 | 148.3                      | -                     | 1.7  | 4.1  |
| <b>Total assets</b>  | <b>4,178.0</b>             | <b>460.4</b>          | <b>431.0</b>   | <b>471.7</b>   |
| Current liabilities  | 1,246.9                    | 39.4                  | 41.8   | 85.3   |
| Long-term liabilities  | 1,886.1                    | 165.7                 | 132.8  | 102.1  |
| Minority interest  | 771.0                      | -                     | 1.1  | 6.0  |
| Convertible debentures   | -                          | -                     | -  | 11.7   |
| Receipts on account of options issued in subsidiaries              | 18.7                       | -                     | -  | -  |
| Shareholders' equity   | 255.3                      | 255.3                 | 255.3  | 266.6  |
| <b>Total liabilities and shareholders' equity</b>                  | <b>4,178.0</b>             | <b>460.4</b>          | <b>431.0</b>   | <b>471.7</b>   |

(\*) The balance sheet of the Company and private companies it controls – means the consolidated balance sheet which includes, under the equity method, public subsidiaries held directly by the Company (Leader and Technologies).

- The Company's shareholders' equity totaled NIS 255.3 million as of June 30, 2006, compared with NIS 266.3 million as of December 31, 2005, representing 59% of total assets of the Company and the companies it controls.

The changes in shareholders' equity in the reporting period derive mainly from the Company's income of NIS 2.3, offset by a dividend of NIS 14.8 million that was paid by the Company during the reporting period.

- Current assets totaled NIS 105.5 million as of June 30, 2006, compared with NIS 145.7 million at the end of 2005. The decrease in current assets was due mainly to the decrease in the cash balances used primarily in making investments and paying dividends.
- Investments and loans in investee and other companies totaled NIS 299.3 million at the end of June 2006, compared with NIS 296.7 million at the end of December 2005. The increase in this item is explained by the Company's share in the income of investees of NIS 8.4 million (mainly Leader) during the period, offset by the Company's share of the dividend from Leader of NIS 8.6 million, as well as the acquisition of Technologies' shares from Marubeni, as described previously.
- The financial liabilities of the Company and the private companies it controls totaled NIS 174.6, compared with NIS 199.1 million at the end of 2005, reflecting the continued trend of improved liquidity and the reduction in the Company's liabilities. The net financial liabilities of the Company as of the end of June 2006, net of liquid resources, total NIS 69 million.

#### **4. Operating results of the Company and the companies it controls**

##### **General**

The Company ended the reporting period with income of NIS 2.3 million, compared with income of NIS 55.0 million in the same period last year, and a loss of NIS 9.8 million in the Quarter, compared with income of NIS 15.1 million in the same quarter last year. The profitability of the previous reporting periods for the year 2005 was characterized by profits in the capital markets (especially in respect of the activity of the Sphera Fund), profits from long-term investments on the sale of the balance of the Company's holdings in DS Securities, and from profits of investee companies, mainly Leader.

The following table presents data taken from the consolidated statements of operations of the Company and the companies it controls (in reported NIS millions of June 2006):

**THE COLUMNS OF THE TABLE HAVE TO BE DONE**

**Headings: First Half 2006, First Half 2005, QII 2006, QII 2005**

|  | Half I<br>2006 | Half I<br>2005 | Quarter I<br>2006 | Quarter I<br>2005 |
|--|----------------|----------------|-------------------|-------------------|
| Revenues from consultancy, management and participation in income of funds | 18.5           | 23.4           | 9.2               | 6.8               |
| Income from long-term investments, net                                     | 4.7            | 5.0            | 4.6               | (0.7)             |
| Gain (loss) from marketable securities, net                                | (1.0)          | 7.7            | (4.3)             | 0.7               |
| Total costs and other expenses   | (18.3)         | (23.0)         | (8.4)             | (11.1)            |
| Income (loss) before financing, net  | 3.9            | 13.1           | 1.1               | (4.3)             |
| Financing expenses, net  | (5.5)          | (4.9)          | (3.8)             | (2.8)             |
| Income (loss) after financing expenses, net                                | (1.6)          | 8.2            | (2.7)             | (7.1)             |
| Taxes on income  | (0.7)          | (0.2)          | (0.2)             | (0.4)             |
| Company's share in results of investees                                    | 8.3            | **51.8         | (5.8)             | 22.8              |
| Loss on decrease in percentage held  | (1.3)          | -              | (0.8)             | -                 |
| Minority interest in results of subsidiaries, net                          | (2.4)          | (4.8)          | (0.3)             | (0.2)             |
| Net income (loss) for the period   | 2.3            | **55.0         | (9.8)             | 15.1              |

(\*) The data for the Company and private companies it controls – means the consolidated statement of operations which includes results, under the equity method, of the public subsidiaries held directly by the Company (Leader and Technologies).

(\*\*) The financial statements were restated – also see Note 1.D to the financial statements.

**The business results of the Company and the private companies it controls, in the reporting period, are explained as follows:**

- The Company and the private companies it controls present turnover from consultancy, management and participation in the income of funds during the reporting period in the amount of NIS 18.5 million, compared with NIS 23.4 million in the same period last year. Total revenues for the Quarter amounted to NIS 9.2 million, compared with NIS 6.8 million in the same quarter last year.

This decrease in the reporting period is the result of the decrease in the Company's share in management fees and participation in the income of the Sphera Fund, due to especially good yields in the same period last year, the effects of the recession on the capital market, and the decrease in revenues from the Company's participation in the income of the funds.

- In the reporting period and the Quarter, the Company posted a loss from marketable securities of NIS 1.0 million and NIS 4.3 million, respectively, compared with income of NIS 7.7 million and NIS 0.7 million in the same periods last year (including income from marketable securities from the Sphera Fund). The decrease in revenues from securities is due to the weakness of the capital market during this period, in comparison with the same period last year and due to the effect of the change in the exchange rate of the US dollar on the assets of the Sphera Fund, as described above. The TA 100 Index decreased by 3.57% in the reporting period, compared with an increase of 3.23% in the same period last year.
- The Company's share in the income of investees in the reporting period amounted to NIS 8.3 million (NIS 51.8 million in the same period last year) and in the second quarter of 2006, a loss of NIS 5.8 million (in the same quarter last year – income of NIS 22.8 million) and derive mainly from the Company's share in the income of Leader. In the reporting period, Leader posted gains of NIS 20 million from the decrease in shareholding percentage due to the issuance of Leader Capital Markets (Company's share of NIS 12 million), which was offset from Leader's share in the results of Polar Investments.
- Total costs and other expenses amounted to NIS 18.3 million in the first half of 2006, compared with NIS 23.0 million in the same period of 2005. Total costs and expenses in the Quarter amounted to NIS 8.4 million, compared with NIS 11.1 million in the same quarter last year. The net decrease in costs during the reporting period originates mainly in the decrease in the accrual of bonuses for senior executives, which are based on the performance of private investees and the consolidated results of the Company, as well as from the decrease in the rate of the bonus to which the chairman of the board of directors and CEO of the Company are entitled, according to their notice to the Company, as described previously.
- Net financing expenses during the reporting period and the second quarter amounted to NIS 5.5 million and NIS 3.8 million, respectively, compared with NIS 4.9 million and NIS 2.8 million in the same periods last year. The increase in financing expenses in the reporting period is due mainly to the higher increase in the ICPI in the reporting period compared with the same period last year, which impacted the Company's ICPI-linked liabilities.

## **5. Consolidated operating results of the Company**

Revenues from sales, services, consultancy, management and underwriting in the Group's consolidated financial statements totaled NIS 957.4 million and NIS 487.1 million in the reporting period and the Quarter, respectively, compared with NIS 925.9 million and 467.7 million in the same periods last year, respectively. The increase in revenues is explained mainly by the growth in the sales of Telit in the telecommunications and technology segment, of Nipson and the paints and insulation products in the industry segment, offset by the decrease in revenues due to the decrease in revenues of Polar Real Estate, the culmination of the Herzliya apartment project and the removal of Maximedia from consolidation in Polar Communications beginning from 2006.

Income from long-term investments and non-current and other assets, net, totaled NIS 67.4 million and NIS 18.7 million in the reporting period and the Quarter, respectively, compared with NIS 268.1 million and NIS 172.5 million in the same periods last year, respectively. The income for the reporting period was due mainly to the gain earned by Polar Communications from the sale of its holdings in Partner, as discussed below, and to the NIS 20 million gain (share of the Company – NIS 12 million) on the decrease in the share of Leader in Leader Capital Markets, as discussed previously. The income in the same periods last year was due mainly to the issuance and sale to a third party of the shares of Nipson by Polar Communications, the gain from the issuance of Telit shares to a third party, the sale of shares of Partner, the gain from the realization of Leader's holdings in BSR and the gain from the realization of the balance of the Company's holdings in DS Securities.

Consolidated financing expenses amounted to NIS 80.6 million and NIS 51.1 million in the reporting period and the Quarter, respectively, compared with NIS 64.4 million and NIS 26.0 million in the same periods last year, respectively. The increase in financing expenses derives mainly from the increase in the "Known" ICPI which increased in the period by 1.3%, compared with 0.5% in the same period last year (an increase of 1.2% in the Quarter, compared with 0.7% in the same quarter last year).

**The following table presents summarized data from the consolidated financial statements (in reported and adjusted NIS millions, as applicable):**

|   | Half I<br>2006 | Half I<br>2005  | Quarter II<br>2006 | Quarter II<br>2005 |
|---|----------------|-----------------|--------------------|--------------------|
| Revenues from sales, services, consultancy, management and underwriting                     | 957.4          | 925.9           | 487.1              | 467.7              |
| Income from long-term investments, assets and others, net                                   | 67.4           | 268.1           | 18.7               | 172.5              |
| Income from marketable securities, net  | 13.9           | 24.0            | -                  | -                  |
| Company's share in income of investees, net   | 2.2            | -               | 2.1                | -                  |
| <b>Total revenues</b>   | <b>1,040.9</b> | <b>1,218.0</b>  | <b>507.9</b>       | <b>640.2</b>       |
| Cost of sales and services  | 713.7          | 687.1           | 359.3              | 350.6              |
| Selling and marketing expenses  | 114.4          | 97.6            | 57.1               | 50.1               |
| Loss on marketable securities, net  | -              | -               | 8.8                | 7.9                |
| General and administrative expenses   | 122.7          | (*)147.6        | 59.2               | 72.3               |
| Company's share in losses of investees, net   | -              | 11.1            | -                  | 4.3                |
| Financing expenses, net   | 80.6           | 64.4            | 51.1               | 26.0               |
| <b>Total expenses</b>   | <b>1,031.4</b> | <b>1,007.8</b>  | <b>535.5</b>       | <b>511.2</b>       |
| <b>Income (loss) before income taxes</b>  | <b>9.5</b>     | <b>210.2</b>    | <b>(27.6)</b>      | <b>129.0</b>       |
| Income taxes  | (12.2)         | (59.0)          | 0.8                | (54.0)             |
| <b>Income (loss) after income taxes</b>   | <b>(2.7)</b>   | <b>151.2</b>    | <b>(26.8)</b>      | <b>75.0</b>        |
| Minority interest in results of subsidiaries, net   | 4.4            | (96.2)          | 17.0               | (59.9)             |
| Cumulative effect as of the beginning of the year of a change in accounting principles, net | 0.6            | -               | -                  | -                  |
| <b>Net income (loss) for the period</b>   | <b>2.3</b>     | <b>(*) 55.0</b> | <b>(9.8)</b>       | <b>15.1</b>        |

(\*) The financial statements were restated - see also Note 1.D to the financial statements.

Regarding information on operating segments, see Note 5 to the financial statements.

## **6. Liquidity**

Cash flows used in the operating activities of the Company and the private companies it controls in the reporting period amounted to NIS 4.3 million. These flows derived mainly from the income of the Company, which was offset by the Company's share in the income of investees, the gain on long-term investments and the decrease in balances of accounts payable.

Cash flows used in investment activities in the reporting period amounted to NIS 3.2 million. These flows were used mainly for long-term investment in investees and other companies, net.

Cash flows used in financing activities totaled NIS 26.7 million in the reporting period. The cash flows were used mainly for the payment of a dividend to the shareholders of the Company in an amount of NIS 15 million and for the payment of a dividend to the minority shareholders in a subsidiary, in an amount of NIS 7 million.

## **7. Sources of financing**

In financing their current operations, the Company and the private companies it controls use their shareholders' equity as well as bank credit and debentures. During 2005, the Group changed the mix of its liabilities, from reliance mainly on bank credit to raising capital through debentures issued in public and private offerings. The liabilities of the Company and the private companies it controls to banks and other lenders and in debentures, net of liquid resources, totaled NIS 69 million as of June 30, 2006.

## **8. Directors with Accounting and Financial Expertise**

There were no significant changes in the reporting period with respect to the disclosure provided on this subject in the Company's Directors' Report that was included in the Periodic Report of the Company for 2005.

## **9. Transactions from operations in the derivatives market**

As of the balance sheet date, a subsidiary of Urdan has a Call option for the purchase of dollars versus the shekel in an amount of \$1.5 million, at exercise rates of between NIS 4.55 to 4.64 to the dollar. The fair value is an asset of NIS 19 thousand.

The aforementioned transactions are for the period ending September 30, 2006. The maximum derivatives position of a subsidiary of Urdan in the reporting period was on April 30, 2006, call options to purchase \$2.5 million. These transactions were for hedging purposes.

As of the balance sheet date, another subsidiary of Urdan has open forward transactions to purchase \$1.3 million for NIS 5.8 million. These trades are for a period of up to one year. They are intended for hedging purposes and their fair value amounts to a loss of NIS 0.1 million. The maximum position of such derivatives in the reporting period and the second quarter was in forward transactions in a total amount of NIS 19.8 million, during the period April 4 – April 9, 2006.

Polar Investments' maximum derivatives position in the reporting period was from January 1, 2006 to February 27, 2006, in call options to purchase €40 million against the sale of dollars, a put option to sell €40 million against the purchase of dollars, and a forward transaction to purchase €10 million against the sale of dollars. As of the date of this report, Polar Investments has no position in derivatives.

In view of the existence of dollar liabilities on the books of the Company and the private companies it controls, the Company and the private companies under its control occasionally execute transactions to hedge the exposure to changes in the dollar exchange rate.

As of June 30, 2006, the Company has open forward transactions for the purchase of \$7.5 million for an amount of NIS 33.5 million, and a transaction to purchase €2 million for an amount of \$2.5 million. These transactions are for the period until September 2006. These transactions had no material impact on the results of operations of the Company for the reporting period. Subsequent to the balance sheet date, the Company carried out an additional forward transaction for the purchase of \$7.5 million for an amount of NIS 33 million in November 2006.

As of the Report date, neither Leader nor Technologies has positions in derivatives.

In addition to the above, the Company and Leader trade, directly and through a subsidiary, in the “Maof” derivatives market through the purchase and sale of financial derivative instruments, so that the maximum exposure deriving from this activity does not exceed NIS 15 million for each one of them. The Company and Leader equally share the risks, expenses and income deriving from these activities.

## **10. Qualitative Report on Exposure to Market Risk and Management Techniques**

There were no significant changes during the reporting period in the Company's exposure to and management of market risk as compared to the report provided in the Company's Directors' Report, which was included in the Company's Periodic Report for the year 2005.

## **11. Charitable Contributions**

The Company regards contributions to the community as an important objective in its business activities and, therefore contributes together with Leader, in equal portions, through the DS Fund, which is a registered foundation that has been recognized as a not-for-profit organization. The principal objective of the foundation, as stipulated upon its establishment is: “to establish a fund in Israel for contributions to charitable institutions and enterprises, to institutions, to the needy and indigent, to educational, cultural, sport, artistic, scientific, research, and educational institutions and enterprises, for scholarships to students, health, welfare and medicine”.

The amount of contributions – of the Company and consolidated (including contributions of the Company’s subsidiaries) during the reporting period was NIS 260 thousand and NIS 1,168 thousand, respectively. The amount of contributions – of the Company and consolidated – in the year 2005 was NIS 357 thousand and NIS 1,653 thousand, respectively.

## **12. Peer Review**

On July 28, 2005, the Israel Securities Authority issued a guideline under Article 36A of the Israeli Securities Law – 1968 in the matter of disclosure pertaining to the agreement to conduct a peer review, the goal of which, according to the guideline, is to initiate a control process regarding the work of accounting firms, and an assessment of the existence of the necessary procedures during the audit work performed by such firms, which would contribute to the existence of a progressive capital market.

The board of directors of the Company granted its consent to have the performance of a peer review.

## **13. Disclosure pertaining to the Corporation's Internal Auditor**

There were no significant changes in the reporting period with respect to the disclosure related to the Internal Auditor provided in the Company's Directors' Report that was included in the Periodic Report of the Company for 2005.

#### 14. Linkage Basis Report (in reported NIS in millions)

|  | <u>Unlinked</u> | <u>Linked to<br/>the CPI</u> | <u>In or linked<br/>to foreign<br/>currency (*)</u> | <u>Other / Non-<br/>monetary<br/>balances</u> | <u>Total</u>   |
|--|-----------------|------------------------------|---|---|----------------|
| <b>As of June 30, 2006</b>                               |                 |                              |   |   |                |
| <b>Assets</b>  |                 |                              |   |   |                |
| Cash and cash equivalents                                | 258.2           | -                            | 136.0   | -   | 394.2          |
| Marketable securities                                    | 178.1           | 21.3                         | 196.2   | -   | 395.6          |
| Short-term deposits and investments                      | 110.5           | -                            | 1.5   | -   | 112.0          |
| Current maturities and loans granted                     | 11.3            | 5.1                          | 0.2   | -   | 16.6           |
| Trade accounts receivable                                | 349.9           | 2.0                          | 179.6   | 3.9   | 535.4          |
| Accounts receivable and other debit balances             | 72.0            | 9.3                          | 60.3  | 28.4  | 170.0          |
| Inventory and work in progress                           | -               | -                            | -   | 449.3   | 449.3          |
| Real property  | -               | -                            | -   | 538.6   | 538.6          |
| Long-term investments in investee and<br>other companies | 56.6            | 101.5                        | 156.5   | 408.9   | 723.5          |
| Long-term deposits and loans granted                     | 10.9            | 49.5                         | 33.4  | -   | 93.8           |
| Fixed assets, net  | -               | -                            | -   | 600.8   | 600.8          |
| Other assets and deferred expenses                       | -               | -                            | -   | 148.2   | 148.2          |
| <b>Total assets</b>                                      | <u>1,047.5</u>  | <u>188.7</u>                 | <u>763.7</u>  | <u>2,178.1</u>                                | <u>4,178.0</u> |
| <b>Liabilities</b>                                       |                 |                              |   |   |                |
| Short-term credit from banks and others                  | 337.3           | 197.4                        | 86.1  | -   | 620.8          |
| Trade accounts payable                                   | 128.2           | 10.0                         | 130.4   | 0.7   | 269.3          |
| Accounts payable and other credit balances               | 160.3           | 34.2                         | 47.6  | 14.3  | 256.4          |
| Advances from customers                                  | 33.2            | -                            | -   | 67.2  | 100.4          |
| Proposed dividend  | -               | -                            | -   | -   | -              |
| Long-term liabilities to banks and others                | 371.0           | 509.5                        | 209.4   | -   | 1,089.9        |
| Debentures   | -               | 557.7                        | 60.5  | -   | 618.2          |
| Convertible debentures                                   | -               | 121.5                        | 31.3  | -   | 152.8          |
| Severance pay, net                                       | -               | -                            | -   | 15.3  | 15.3           |
| Deferred taxes   | -               | -                            | -   | 9.9   | 9.9            |
| <b>Total liabilities</b>                                 | <u>1,030.0</u>  | <u>1,430.3</u>               | <u>565.3</u>  | <u>107.4</u>                                  | <u>3,133.0</u> |
| Minority interests                                       | -               | -                            | -   | 771.0   | 771.0          |
| Receipts on account of options issued in<br>subsidiaries | -               | -                            | -   | 18.7  | 18.7           |
| Shareholders' equity                                     | -               | -                            | -   | 255.3   | 255.3          |
|  | <u>-</u>        | <u>-</u>                     | <u>-</u>  | <u>1,045.0</u>                                | <u>1,045.0</u> |
|  | <u>1,030.0</u>  | <u>1,430.3</u>               | <u>565.3</u>  | <u>1,152.4</u>                                | <u>4,178.0</u> |
|  | <u>17.5</u>     | <u>(1,241.6)</u>             | <u>198.4</u>  | <u>1,025.7</u>                                | <u>-</u>       |

(\*) Mainly to the exchange rate of the U.S. dollar.

|  | <u>In or linked<br/>to foreign<br/>currency (*)</u> | <u>Linked to<br/>the CPI</u> | <u>Unlinked</u>     | <u>Non-<br/>monetary<br/>balances</u> | <u>Total</u>          |
|--|---|------------------------------|---------------------|---------------------------------------|-----------------------|
| <b>As of December 31, 2006</b>                           |   |                              |                     |                                       |                       |
| <b>Assets:</b>   |   |                              |                     |                                       |                       |
| Cash and cash equivalents                                | 351.6   | -                            | **203.4             | -                                     | 555.0                 |
| Marketable securities                                    | 369.2   | 4.5                          | 76.0                | -                                     | 449.7                 |
| Short-term deposits and investments                      | -   | 2.0                          | **55.3              | -                                     | 57.3                  |
| Current maturities and loans granted                     | -   | 14.9                         | -                   | -                                     | 14.9                  |
| Trade accounts receivable                                | **381.5   | 1.0                          | 172.9               | -                                     | 555.4                 |
| Accounts receivable and other debit<br>balances          | 59.3  | 26.2                         | 44.8                | 12.8                                  | 143.1                 |
| Inventory and work in progress                           | -   | -                            | -                   | 366.3                                 | 366.3                 |
| Real property  | -   | -                            | -                   | 634.1                                 | 634.1                 |
| Long-term investments in investee and<br>other companies | 39.4  | 130.8                        | 77.7                | 374.3                                 | 622.2                 |
| Long-term deposits and loans granted                     | 6.4   | 107.1                        | 0.9                 | -                                     | 114.4                 |
| Fixed assets, net  | -   | -                            | -                   | 646.6                                 | 646.6                 |
| Other assets and deferred expenses                       | -   | -                            | -                   | 135.4                                 | 135.4                 |
| <b>Total assets</b>                                      | <b><u>1,207.4</u></b>                               | <b><u>286.5</u></b>          | <b><u>631.0</u></b> | <b><u>2,169.5</u></b>                 | <b><u>4,294.4</u></b> |
| <b>Liabilities:</b>                                      |   |                              |                     |                                       |                       |
| Short-term credit from banks and others                  | 412.8   | 329.5                        | 127.5               | -                                     | 869.8                 |
| Trade accounts payable                                   | 121.3   | 9.0                          | 110.0               | 0.7                                   | 241.0                 |
| Accounts payable and other credit<br>balances            | 172.0   | 44.9                         | 52.8                | 10.1                                  | 279.8                 |
| Advances from customers                                  | 98.2  | -                            | -                   | -                                     | 98.2                  |
| Long-term liabilities to banks and others                | 366.2   | 483.5                        | 198.3               | -                                     | 1,048.0               |
| Debentures   | -   | 510.5                        | 61.5                | -                                     | 572.0                 |
| Convertible debentures                                   | -   | 138.1                        | 11.6                | -                                     | 149.7                 |
| Severance pay, net                                       | 0.8   | -                            | -                   | 12.2                                  | 13.0                  |
| Deferred taxes   | -   | -                            | -                   | 10.8                                  | 10.8                  |
| <b>Total liabilities</b>                                 | <b><u>1,171.3</u></b>                               | <b><u>1,515.5</u></b>        | <b><u>561.7</u></b> | <b><u>33.8</u></b>                    | <b><u>3,282.3</u></b> |
| Minority interests                                       | -   | -                            | -                   | ***717.5                              | 717.5                 |
| Receipts on account of options issued in<br>subsidiaries | 1.8   | -                            | -                   | ***14.5                               | 16.3                  |
| Convertible debentures (quasi-equity)                    | -   | -                            | -                   | 11.7                                  | 11.7                  |
| Shareholders' equity                                     | -   | -                            | -                   | 266.6                                 | 266.6                 |
|  | <u>1.8</u>  | <u>-</u>                     | <u>-</u>            | <u>1,010.3</u>                        | <u>1,012.1</u>        |
|  | <b><u>1,173.1</u></b>                               | <b><u>1,515.5</u></b>        | <b><u>561.7</u></b> | <b><u>1,044.1</u></b>                 | <b><u>4,294.4</u></b> |
|  | <b><u>34.3</u></b>                                  | <b><u>(1,229.0)</u></b>      | <b><u>69.3</u></b>  | <b><u>1,125.4</u></b>                 | <b><u>-</u></b>       |

(\*) Mainly to the exchange rate of the US dollar.

(\*\*) Reclassified.

(\*\*\*) Restated.

**The Company thanks its employees for their contribution to the Company and its shareholders for their trust.**

\_\_\_\_\_  
**Itschak Shrem-Chairman of the Board**

\_\_\_\_\_  
**Yair Fudim, CEO and Director**

**Date:** August 30, 2006

**Consolidated Balance Sheets****Reported amounts**

|   | <b>June 30<br/>2006</b> | <b>June 30<br/>2005</b> | <b>December 31<br/>2005</b> |
|---|-------------------------|-------------------------|-----------------------------|
|   | <b>(Unaudited)</b>      | <b>(Unaudited)</b>      | <b>(Audited)</b>            |
|   | <b>NIS thousands</b>    | <b>NIS thousands</b>    | <b>NIS thousands</b>        |
| <b>Current assets</b>                                     |                         |                         |                             |
| Cash and cash equivalents                                 | 394,171                 | 625,657                 | *554,989                    |
| Deposits and short-term investments                       | 111,952                 | 62,255                  | *57,243                     |
| Marketable securities                                     | 395,635                 | 313,657                 | 449,732                     |
| Current maturities and loans receivable                   | 16,518                  | 21,535                  | 14,896                      |
| Trade receivables   | 535,434                 | 539,507                 | 555,417                     |
| Other receivables   | 169,955                 | 138,557                 | 143,109                     |
| Inventory and work-in-process                             | 449,339                 | 352,761                 | 366,287                     |
|   | <b>2,073,004</b>        | <b>2,053,929</b>        | <b>2,141,673</b>            |
| <b>Real estate</b>  | <b>538,614</b>          | <b>576,370</b>          | <b>634,111</b>              |
| <b>Investments and long-term loans</b>                    |                         |                         |                             |
| Investments in investee and other companies               | 723,459                 | 656,171                 | 622,154                     |
| Loans and deposits  | 93,858                  | 82,094                  | 114,415                     |
|   | <b>817,317</b>          | <b>738,265</b>          | <b>736,569</b>              |
| <b>Fixed assets</b>                                       | <b>600,806</b>          | <b>712,008</b>          | <b>646,574</b>              |
| <b>Other assets and deferred expenses</b>                 | <b>148,226</b>          | <b>115,172</b>          | <b>135,401</b>              |
|   | <b>4,177,967</b>        | <b>4,195,744</b>        | <b>4,294,328</b>            |
| <b>Current liabilities</b>                                |                         |                         |                             |
| Credit from banks and others                              | 620,779                 | 832,603                 | 869,677                     |
| Suppliers and service providers                           | 269,333                 | 240,700                 | 241,005                     |
| Accounts payable and credit balances                      | 256,360                 | **302,322               | 279,799                     |
| Customer deposits   | 100,445                 | 65,827                  | 98,212                      |
|   | <b>1,246,917</b>        | <b>*1,441,452</b>       | <b>1,488,693</b>            |
| <b>Long-term liabilities</b>                              |                         |                         |                             |
| Credit from banks and others                              | 1,089,886               | 1,059,747               | 1,048,030                   |
| Debentures  | 618,232                 | 492,596                 | 571,945                     |
| Debentures convertible into shares                        | 152,822                 | 197,924                 | 149,692                     |
| Employee retirement benefit, net                          | 15,250                  | 18,406                  | 13,030                      |
| Deferred taxes  | 9,856                   | 10,631                  | 10,821                      |
|   | <b>1,886,046</b>        | <b>1,779,304</b>        | <b>1,793,518</b>            |
| <b>Minority interest</b>                                  | <b>771,047</b>          | <b>**676,275</b>        | <b>**717,315</b>            |
| <b>Receipts from share options issued by subsidiaries</b> | <b>18,680</b>           | <b>17,766</b>           | <b>*16,543</b>              |
| <b>Debentures convertible into company shares</b>         | <b>-</b>                | <b>11,654</b>           | <b>11,727</b>               |
| <b>Shareholders' equity</b>                               | <b>255,277</b>          | <b>**269,293</b>        | <b>*266,532</b>             |
|   | <b>4,177,967</b>        | <b>4,195,744</b>        | <b>4,294,328</b>            |

Date of approval: August 30, 2006

\* Reclassified

\*\* Restated

**Consolidated Statements of Operations****Reported amounts**

|   | For the six months ended     |                              | For the three months ended   |                              | For the year ended         |
|---|------------------------------|------------------------------|------------------------------|------------------------------|----------------------------|
|   | June 30<br>2006              | June 30<br>2005              | June 30<br>2006              | June 30<br>2005              | December 31<br>2005        |
|   | (Unaudited)<br>NIS thousands | (Unaudited)<br>NIS thousands | (Unaudited)<br>NIS thousands | (Unaudited)<br>NIS thousands | (Audited)<br>NIS thousands |
| <b>Income</b>   |                              |                              |                              |                              |                            |
| Income from sales, services, consulting, management and underwriting                            | 957,418                      | *925,912                     | 487,098                      | *467,706                     | 1,903,522                  |
| Gain on marketable securities, net  | 13,887                       | 23,987                       | -                            | -                            | 66,779                     |
| Gain on sales of investments, loans and assets, net   | 67,363                       | 268,129                      | 18,656                       | 172,468                      | 357,164                    |
| Company's equity in earnings of investment, net   | 2,178                        | -                            | 2,102                        | -                            | -                          |
|   | <u>1,040,846</u>             | <u>1,218,028</u>             | <u>507,856</u>               | <u>640,174</u>               | <u>2,327,465</u>           |
| <b>Costs and expenses</b>   |                              |                              |                              |                              |                            |
| Cost of sales and services  | 713,733                      | 687,064                      | 359,223                      | 350,607                      | *1,465,537                 |
| Selling and marketing   | 114,347                      | 97,609                       | 57,126                       | 50,118                       | 202,650                    |
| Loss on marketable securities, net  | -                            | -                            | 8,837                        | 7,879                        | -                          |
| General and administrative  | 122,712                      | *147,603                     | 59,201                       | *72,287                      | 268,800                    |
| Company's equity in loss of investment, net   | -                            | 11,098                       | -                            | 4,323                        | 21,942                     |
| Financing expenses, net   | 80,629                       | 64,454                       | 51,109                       | 26,025                       | 160,983                    |
|   | <u>1,031,421</u>             | <u>1,007,828</u>             | <u>535,496</u>               | <u>511,239</u>               | <u>2,119,912</u>           |
| <b>Earnings before taxation income</b>  | <b>9,425</b>                 | <b>210,200</b>               | <b>(27,640)</b>              | <b>128,935</b>               | <b>207,553</b>             |
| Tax benefit (Taxes on income)   | (12,187)                     | *(59,025)                    | 787                          | (53,943)                     | *(67,833)                  |
| <b>Earnings (losses) from operations after taxes on income</b>                                  | <b>(2,762)</b>               | <b>151,175</b>               | <b>(26,853)</b>              | <b>74,992</b>                | <b>139,720</b>             |
| Minority interest in earnings of subsidiaries, net  | 4,418                        | *(96,160)                    | 17,006                       | (59,916)                     | *(81,303)                  |
| <b>Earnings (losses) from operation activities</b>  | <b>1,656</b>                 | <b>55,015</b>                | <b>(9,847)</b>               | <b>15,076</b>                | <b>58,417</b>              |
| Cumulative effect as at beginning of year of change in accounting principles, net               | 619                          | -                            | -                            | -                            | -                          |
| <b>Net earnings (losses) for the</b>  | <b>2,275</b>                 | <b>55,015</b>                | <b>(9,847)</b>               | <b>15,076</b>                | <b>58,417</b>              |
| <b>Net earning per share capital*:</b>  |                              |                              |                              |                              |                            |
| Basic earnings (losses) per share:  |                              |                              |                              |                              |                            |
| Earnings (losses) from operating activities   | 0.10                         | 3.01                         | (0.55)                       | 0.83                         | 3.20                       |
| Earnings from cumulative effect as at beginning of year of change in accounting principles, net | 0.03                         | -                            | -                            | -                            | -                          |
|   | <u>0.13</u>                  | <u>3.01</u>                  | <u>(0.55)</u>                | <u>0.83</u>                  | <u>3.20</u>                |
| Diluted earnings (losses) per share:  |                              |                              |                              |                              |                            |
| Earnings (losses) from operating activities   | (0.01)                       | 1.86                         | (0.79)                       | 0.36                         | 2.39                       |
| Earnings from cumulative effect as at beginning of year of change in accounting principles, net | 0.03                         | -                            | -                            | -                            | -                          |
|   | <u>0.02</u>                  | <u>1.86</u>                  | <u>(0.79)</u>                | <u>0.36</u>                  | <u>2.39</u>                |

\* Restated

**Statements of Changes in Shareholders' Equity****Reported amounts**

|  | Share capital | Premium on shares and capital reserves | Receipts from issuance of options | 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 | Dividend proposed | Retained earnings | Total          |
|--|---------------|--|-----------------------------------|--|---|---|-------------------|-------------------|----------------|
|  | NIS thousands |  |                                   |  |   |   |                   |                   |                |
| <b>Balance as at January 1, 2006 (Audited)</b>   | <b>25,548</b> | <b>166,539</b>                         | <b>3,201</b>                      | <b>(102)</b>   | <b>(1,199)</b>                                | <b>(7,300)</b>                                    | <b>**14,379</b>   | <b>**65,466</b>   | <b>266,532</b> |
| <b>Six month period ended June 30, 2006 (Unaudited)</b>                                  |               |  |                                   |  |   |   |                   |                   |                |
| Inclusion of negative goodwill in retained earnings (*)                                  | -             | -                                      | -                                 | -  | -   | -   | -                 | 1,230             | 1,230          |
| Splitting of capital component from convertible debentures (*)                           | -             | -                                      | 592                               | -  | -   | -   | -                 | -                 | 592            |
| Purchase of company shares   | -             | -                                      | -                                 | -  | -   | (1,379)   | -                 | -                 | (1,379)        |
| Conversion of employee options into shares of the Company                                | 115           | (115)                                  | -                                 | -  | -   | -   | -                 | -                 | -              |
| Dividend   | -             | -                                      | -                                 | -  | -   | -   | (14,379)          | -                 | (14,379)       |
| Adjustments from the translation of financial statements of autonomous foreign investees | -             | -                                      | -                                 | 141  | -   | -   | -                 | -                 | 141            |
| Capital reserves of investee company   | -             | 164                                    | -                                 | -  | -   | -   | -                 | -                 | 164            |
| Repayment of loans to employee for purchase of shares                                    | -             | -                                      | -                                 | -  | 37  | -   | -                 | -                 | 37             |
| Issue of warrants  | -             | -                                      | 64                                | -  | -   | -   | -                 | -                 | 64             |
| Net earnings for the period  | -             | -                                      | -                                 | -  | -   | -   | -                 | 2,275             | 2,275          |
| <b>Balance as at June 30, 2006 (Unaudited)</b>   | <b>25,663</b> | <b>166,588</b>                         | <b>3,857</b>                      | <b>39</b>  | <b>(1,162)</b>                                | <b>(8,679)</b>                                    | <b>-</b>          | <b>68,971</b>     | <b>255,277</b> |

(\*) Initial implementation of accounting standards

(\*\*) Reclassified

**Statements of Changes in Shareholders' Equity****Reported amounts**

|  | Share capital | Premium on shares and capital reserves | Receipts from issuance of options | 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 | Total          |
|--|---------------|--|-----------------------------------|--|---|---|-------------------|----------------|
|  | NIS thousands |  |                                   |  |   |   |                   |                |
| <b>Balance as at January 1, 2005 (Audited)</b>   | 25,360        | 164,850                                | -                                 | 8,670  | (3,194)                                       | (2,451)   | 30,559            | 223,794        |
| <b>Six month period ended June 30, 2005 (Unaudited)</b>                                  |               |  |                                   |  |   |   |                   |                |
| Issuance of options  | -             | -                                      | 3,201                             | -  | -   | -   | -                 | 3,201          |
| Purchase of company shares   | -             | -                                      | -                                 | -  | -   | (383)   | -                 | (383)          |
| Repayment of loan to employees for purchase of shares                                    | -             | -                                      | -                                 | -  | 1,995   | -   | -                 | 1,995          |
| Dividend   | -             | -                                      | -                                 | -  | -   | -   | (9,131)           | (9,131)        |
| Conversion of debentures into shares of the Company                                      | 188           | 1,203                                  | -                                 | -  | -   | -   | -                 | 1,391          |
| Adjustments from the translation of financial statements of autonomous foreign investees | -             | -                                      | -                                 | (6,589)  | -   | -   | -                 | (6,589)        |
| Net earnings for the period  | -             | -                                      | -                                 | -  | -   | -   | *55,015           | *55,015        |
| <b>Balance as at June 30, 2005</b>   | <b>25,548</b> | <b>166,053</b>                         | <b>3,201</b>                      | <b>2,081</b>   | <b>(1,199)</b>                                | <b>(2,834)</b>                                    | <b>76,443</b>     | <b>269,293</b> |

\* Restated.

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

|  | Share<br>capital | Premium<br>on shares<br>and capital<br>reserves | Receipts<br>from<br>issuance<br>of options | Adjustments<br>from the<br>translation<br>of financial<br>statements of<br>autonomous<br>foreign<br>investees<br>of an affiliate | Loans to<br>employees<br>for the<br>purchase<br>of shares | Company<br>shares<br>held by the<br>Company<br>and<br>subsidiary | Retained<br>earnings | Total          |
|--|------------------|---|--|--|---|--|----------------------|----------------|
|  | NIS thousands    |   |  |  |   |  |                      |                |
| <b>Balance as at April 1, 2006 (Audited)</b>   | <b>25,660</b>    | <b>166,510</b>                                  | <b>3,793</b>                               | <b>1,758</b>   | <b>(1,199)</b>  | <b>(8,373)</b>   | <b>**78,531</b>      | <b>266,680</b> |
| <b>Three month period ended June 30, 2006 (Unaudited)</b>                                |                  |   |  |  |   |  |                      |                |
| Inclusion of negative goodwill in retained earnings (*)                                  | -                | -   | -  | -  | -   | -  | 287                  | 287            |
| Purchase of company shares   | -                | -   | -  | -  | -   | (306)  | -                    | (306)          |
| Conversion of employee options into shares of the company                                | 3                | (3)   | -  | -  | -   | -  | -                    | -              |
| Adjustments from the translation of financial statements of autonomous foreign investees | -                | -   | -  | (1,719)  | -   | -  | -                    | (1,719)        |
| Issuance of warrants   | -                | -   | 64   | -  | -   | -  | -                    | 64             |
| Repayment of loans to employee for purchase of shares                                    | -                | -   | -  | -  | 37  | -  | -                    | 37             |
| Capital reserves of investee company   | -                | 81  | -  | -  | -   | -  | -                    | 81             |
| Net losses for the period  | -                | -   | -  | -  | -   | -  | (9,847)              | (9,847)        |
| <b>Balance as at June 30, 2006 (Unaudited)</b>   | <b>25,663</b>    | <b>166,588</b>                                  | <b>3,857</b>                               | <b>39</b>  | <b>(1,162)</b>  | <b>(8,679)</b>   | <b>68,971</b>        | <b>255,277</b> |

\* Initial implementation of accounting standards

\*\* Restated.

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

|   | Share<br>capital | Premium<br>on shares<br>and capital<br>reserves | Receipts<br>from<br>issuance<br>of options | Adjustments<br>from the<br>translation<br>of financial<br>statements of<br>autonomous<br>foreign<br>investees<br>of an affiliate | Loans to<br>employees<br>for the<br>purchase<br>of shares | Company<br>shares<br>held by the<br>Company<br>and<br>subsidiary | Dividend | Retained<br>earnings | Total          |
|---|------------------|---|--|--|---|--|----------|----------------------|----------------|
|   | NIS thousands    |   |  |  |   |  |          |                      |                |
| <b>Balance as at April 1, 2005 (Audited)</b>  | 25,485           | 165,652   | -  | 857  | (3,194)   | (2,451)  | 9,131    | 61,367               | 256,847        |
| <b>Three month period ended June 30, 2005 (unaudited)</b>                               |                  |   |  |  |   |  |          |                      |                |
| Issuance of options   | -                | -   | 3,201                                      | -  | -   | -  | -        | -                    | 3,201          |
| Purchase of Company shares  | -                | -   | -  | -  | -   | (383)  | -        | -                    | (383)          |
| Repayment of loan to employees for purchase of shares                                   | -                | -   | -  | -  | 1,995   | -  | -        | -                    | 1,995          |
| Conversion of debentures into shares of the Company                                     | 63               | 401   | -  | -  | -   | -  | -        | -                    | 464            |
| Adjustments from the translation of financial statements of autonomous foreign investee | -                | -   | -  | 1,224  | -   | -  | -        | -                    | 1,224          |
| Dividend  | -                | -   | -  | -  | -   | -  | (9,131)  | -                    | (9,131)        |
| Net earnings for the period   | -                | -   | -  | -  | -   | -  | -        | 15,076               | 15,076         |
| <b>Balance as at June 30, 2005</b>  | <u>25,548</u>    | <u>166,053</u>                                  | <u>3,201</u>                               | <u>2,081</u>   | <u>(1,199)</u>  | <u>(2,834)</u>   | <u>-</u> | <u>76,443</u>        | <u>269,293</u> |

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

|  | Share<br>capital | Premium on<br>shares and<br>capital<br>reserves | Receipts<br>from<br>issuance<br>of options | Adjustments<br>from the<br>translation<br>of financial<br>statements of<br>autonomous<br>foreign<br>investees | Loans to<br>employees<br>for<br>purchase<br>of shares | Company<br>shares<br>held by the<br>Company<br>and<br>subsidiary | Dividend<br>declared<br>subsequent<br>to balance<br>sheet date | Retained<br>earnings | Total          |
|--|------------------|---|--|---|---|--|--|----------------------|----------------|
|  | NIS thousands    | NIS thousands                                   | NIS thousands                              | NIS thousands   | NIS thousands   | NIS thousands  | NIS thousands  | NIS thousands        | NIS thousands  |
| <b>Balance as at January 1, 2005 (Audited)</b>   | 25,360           | 164,850   | -  | 8,670   | (3,194)   | (2,451)  | -  | 30,559               | 223,794        |
| <b>Changes in the year ended December 31, 2005 (Audited)</b>                             |                  |   |  |   |   |  |  |                      |                |
| Purchase of company shares   | -                | -   | -  | -   | -   | (4,849)  | -  | -                    | (4,849)        |
| Issuance of options  | -                | -   | 3,201                                      | -   | -   | -  | -  | -                    | 3,201          |
| Capital reserves of investee company   | -                | 486   | -  | -   | -   | -  | -  | -                    | 486            |
| Conversion of debentures into shares of the Company                                      | 188              | 1,203   | -  | -   | -   | -  | -  | -                    | 1,391          |
| Adjustments from the translation of financial statements of autonomous foreign investees | -                | -   | -  | (8,772)   | -   | -  | -  | -                    | (8,772)        |
| Repayment of loan to employees for purchase of shares                                    | -                | -   | -  | -   | 1,995   | -  | -  | -                    | 1,995          |
| Dividend   | -                | -   | -  | -   | -   | -  | -  | (9,131)              | (9,131)        |
| Dividend declared subsequent to balance sheet date                                       | -                | -   | -  | -   | -   | -  | *14,379  | *(14,379)            | -              |
| Net earnings for the year  | -                | -   | -  | -   | -   | -  | -  | **58,417             | 58,417         |
| <b>Balance as at December 31, 2005 (Audited)</b>   | <b>25,548</b>    | <b>166,539</b>                                  | <b>3,201</b>                               | <b>(102)</b>  | <b>(1,199)</b>  | <b>(7,300)</b>   | <b>14,379</b>  | <b>65,466</b>        | <b>266,532</b> |

\* Reclassified

\*\* Restated.

**Consolidated Statements of Cash Flows****Reported amounts**

|   | For the six months ended |                 | For the three months ended |                 | For the year ended  |
|---|--------------------------|-----------------|----------------------------|-----------------|---------------------|
|   | June 30<br>2006          | June 30<br>2005 | June 30<br>2006            | June 30<br>2005 | December 31<br>2005 |
|   | (Unaudited)              | (Unaudited)     | (Unaudited)                | (Unaudited)     | (Audited)           |
|   | NIS thousands            | NIS thousands   | NIS thousands              | NIS thousands   | NIS thousands       |
| <b>Cash flows from operating activities:</b>  |                          |                 |                            |                 |                     |
| Net earnings (losses)   | 2,275                    | * 55,015        | (9,847)                    | 15,076          | * 58,417            |
| Adjustments required to reconcile cash from operating activities (Annex A)                                    | 32,688                   | *(33,398)       | 32,228                     | (8,619)         | *(102,222)          |
| Net cash outflow from (used to) operating activities  | 34,963                   | 21,617          | 22,381                     | 6,457           | (43,805)            |
| <b>Cash flows from investing activities:</b>  |                          |                 |                            |                 |                     |
| Purchase of fixed assets, real estate and amounts charged to projects under construction and other assets     | (28,719)                 | ** (141,498)    | (17,654)                   | ** (24,270)     | ** (230,642)        |
| Proceeds from sale of fixed assets and other assets   | 22,368                   | ** 43,505       | 17,617                     | ** 1,276        | ** 110,523          |
| Proceeds (purchase) from sale of marketable, securities short-term investments and deposits, net              | 38,778                   | (122,026)       | (27,975)                   | (22,223)        | (150,711)           |
| Investments in investee and other companies (including through loans and capital notes), net                  | (186,686)                | (72,856)        | (110,724)                  | (45,029)        | (128,333)           |
| Changes in deposits and loans granted, net  | 8,183                    | (13,184)        | (535)                      | 13,298          | ** (60,418)         |
| Proceeds from sale of investment in investee and other companies  | 155,464                  | 356,782         | 124,315                    | 142,010         | 467,535             |
| Initially fully or proportionately consolidated companies and acquisition of activities (Annex C)             | -                        | -               | -                          | -               | 7                   |
| Companies formerly fully or proportionately consolidated no longer consolidated and activities sold (Annex D) | (121)                    | -               | -                          | -               | 6,689               |
| Companies formerly proportionately consolidated initially fully consolidated (Annex E)                        | (6,682)                  | 478             | (8,959)                    | -               | (2,690)             |
| Net cash inflow from investment activities  | 2,585                    | 51,201          | (23,915)                   | 65,062          | 11,960              |

\* Restated

\*\* Reclassified

**Consolidated Statements of Cash Flows****Reported amounts**

|   | <b>For the six months ended</b> |                         | <b>For the three months ended</b> |                         | <b>For the year ended</b>   |
|---|---------------------------------|-------------------------|-----------------------------------|-------------------------|-----------------------------|
|   | <b>June 30<br/>2006</b>         | <b>June 30<br/>2005</b> | <b>June 30<br/>2006</b>           | <b>June 30<br/>2005</b> | <b>December 31<br/>2005</b> |
|   | <b>(Unaudited)</b>              | <b>(Unaudited)</b>      | <b>(Unaudited)</b>                | <b>(Unaudited)</b>      | <b>(Audited)</b>            |
|   | <b>NIS thousands</b>            | <b>NIS thousands</b>    | <b>NIS thousands</b>              | <b>NIS thousands</b>    | <b>NIS thousands</b>        |
| <b>Cash flows from financing activities:</b>  |                                 |                         |                                   |                         |                             |
| Purchase of company shares by subsidiary  | (1,379)                         | (383)                   | (306)                             | (383)                   | (4,849)                     |
| Issue of debentures and convertible debentures in consolidated companies, net   | 59,717                          | -                       | 16,651                            | -                       | 63,479                      |
| Issuance of debentures and convertible debentures (net of issuance expenses) into shares of the Company                     | -                               | 67,912                  | -                                 | 56,999                  | 67,912                      |
| Dividend to minority in subsidiaries  | (34,104)                        | (33,787)                | (24,629)                          | (22,751)                | (35,277)                    |
| Receipt (repayment) of loans and capital notes, net   | (97,258)                        | (225,853)               | 9,575                             | (149,240)               | (238,869)                   |
| Issuance of marketable securities of subsidiaries   | 46,838                          | 695,774                 | 25,587                            | 467,695                 | 725,081                     |
| Receipt (repayment) of short- term credit, net  | (23,939)                        | (93,942)                | 20,358                            | (100,943)               | (52,963)                    |
| Repayment of convertible debentures in consolidated companies   | (137,299)                       | (61,715)                | (75,767)                          | (50,689)                | (131,989)                   |
| Issuance of options warrants (less issuance expenses)   | -                               | 3,201                   | -                                 | 3,201                   | 3,201                       |
| Proceeds from sale of subsidiary  | 978                             | -                       | -                                 | -                       | -                           |
| Repayment of loans for purchase of shares   | 37                              | 1,995                   | 37                                | 1,995                   | 1,995                       |
| Dividend  | (14,379)                        | (9,131)                 | (14,379)                          | (9,131)                 | (9,131)                     |
| <b>Net cash outflow from (used in) financing activities</b>   | <b>(200,788)</b>                | <b>344,071</b>          | <b>(42,873)</b>                   | <b>196,753</b>          | <b>388,590</b>              |
| <b>Translation differences with respect to cash balances with respect to cash balances in autonomous investee companies</b> | <b>2,422</b>                    | <b>(2,603)</b>          | <b>26</b>                         | <b>(1,529)</b>          | <b>(13,127)</b>             |
| <b>Increase (decrease) in cash and cash equivalents</b>   | <b>(160,818)</b>                | <b>414,286</b>          | <b>(44,381)</b>                   | <b>266,743</b>          | <b>343,618</b>              |
| <b>Balance of cash and cash equivalents at beginning of period</b>  | <b>554,989</b>                  | <b>211,371</b>          | <b>*438,552</b>                   | <b>358,914</b>          | <b>211,371</b>              |
| <b>Balance of cash and cash equivalents at end of period</b>  | <b>394,171</b>                  | <b>625,657</b>          | <b>394,171</b>                    | <b>625,657</b>          | <b>*554,989</b>             |

\* Reclassified

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

|  | For the six months ended                        |  | For the three months ended                      |  | For the year ended                                   |
|--|---|--|---|--|--|
|  | June 30<br>2006<br>(Unaudited)<br>NIS thousands | June 30<br>*2005<br>(Unaudited)<br>NIS thousands | June 30<br>2006<br>(Unaudited)<br>NIS thousands | June 30<br>*2005<br>(Unaudited)<br>NIS thousands | December 31<br>2005<br>(Audited)<br>NIS<br>thousands |
| <b>Income and expenses not involving cash flows:</b>                                       |   |  |   |  |  |
| Depreciation and amortization  | 24,041  | * 26,080   | 12,016  | 11,474   | 78,033   |
| Company's equity in losses (earnings) of investee companies less of dividend received, net | (2,318)   | 13,086   | (2,097)   | 5,153  | * 26,974   |
| Minority interest in results of subsidiaries, net  | (4,418)   | * 96,160   | (17,006)  | 59,916   | *81,303  |
| Loss (gain) on marketable securities and deposits, net                                     | (16,985)  | (25,353)   | 2,427   | (2,563)  | (56,703)   |
| Expenses from financing activities, net  | 23,116  | 7,296  | 21,965  | 10,404   | 27,405   |
| Deferred taxes, net  | 3,645   | 36,423   | 2,598   | 38,601   | 42,011   |
| Increase (decrease) in liability for employee severance benefits, net                      | 1,998   | 936  | 1,281   | 580  | (3,450)  |
| Gain on sale and amortization of investments and assets, net                               | (42,952)  | (267,843)  | (15,342)  | (173,178)  | (366,166)  |
| Cost of share-based payment transactions   | 873   | -  | 450   | -  | -  |
| Cumulative effect as at beginning of year of change in accounting principles, net          | (619)   | -  | -   | -  | -  |
| Expenses from issuance of employee options, net  | -   | -  | -   | -  | *597   |
| <b>Changes in asset and liability items:</b>   |   |  |   |  |  |
| Decrease (increase) in trade receivables and other receivables                             | 15,254  | *36,237  | 11,593  | 22,057   | (23,393)   |
| Decrease (increase) in inventory and in land business inventory holdings, net              | 37,536  | (5,632)  | (6,219)   | (9,503)  | (23,869)   |
| Increase (decrease) in suppliers and service providers                                     | (6,483)   | * 49,212   | 20,562  | 28,440   | *115,036   |
|  | <u>32,688</u>                                   | <u>(33,398)</u>                                  | <u>32,228</u>                                   | <u>(8,619)</u>                                   | <u>(102,222)</u>                                     |

\* Restated

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

|  | For the six months ended                        |   | For the three months ended                      |   | For the year ended                                |
|--|---|---|---|---|---|
|  | June 30<br>2006<br>(Unaudited)<br>NIS thousands | June 30<br>2005<br>(Unaudited)<br>NIS thousands | June 30<br>2006<br>(Unaudited)<br>NIS thousands | June 30<br>2005<br>(Unaudited)<br>NIS thousands | December 31<br>2005<br>(Audited)<br>NIS thousands |
| Amount receivables in respect of sale investments              | 4,400   | -   | 4,400   | -   | -   |
| Conversion of convertible bonds into Company shares            | -   | 1,391   | -   | 464   | 1,391   |
| Liability to invest in other companies                         | 175   | 84  | 175   | 84  | 84  |
| Amount receivable in respect of sale of short-term investments | -   | 1,102   | -   | 1,102   | -   |
| Proceeds from sale of long-term investment                     | 6,732   | -   | 6,732   | -   | -   |
| Purchase of fixed assets and land on credit                    | 3,664   | -   | 723   | -   | 1,468   |
| Sale on credit of fixed assets and land on credit              | -   | -   | -   | -   | 10,438  |
| Amount payables in respect of issuance expenses                | -   | 465   | -   | 465   | -   |
| Conversion of debentures into shares of subsidiary             | 11,565  | 10,386  | 7,388   | 10,386  | *38,686   |
| Dividend in kind for minority                                  | 38,816  | -   | 38,816  | -   | -   |

**Annex C - Initially fully or proportionately consolidated companies and acquisition of activities****Assets and liabilities of the subsidiaries as at date of consolidation**

|   |   |   |   |   |          |
|---|---|---|---|---|----------|
| Working capital, net (exclude cash and cash equivalents)              | - | - | - | - | 1,279    |
| Excess cost   | - | - | - | - | (10,502) |
| Balance of investment in companies as at date of initial consolidated | - | - | - | - | 8,235    |
| Minority share in deficiency  | - | - | - | - | (1,426)  |
| Long term liabilities   | - | - | - | - | 2,421    |
|   | - | - | - | - | 7        |

\* Reclassified

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

|  | For the six months ended                        |   | For the three months ended                      |   | For the year ended                                |
|--|---|---|---|---|---|
|  | June 30<br>2006<br>(Unaudited)<br>NIS thousands | June 30<br>2005<br>(Unaudited)<br>NIS thousands | June 30<br>2006<br>(Unaudited)<br>NIS thousands | June 30<br>2005<br>(Unaudited)<br>NIS thousands | December 31<br>2005<br>(Audited)<br>NIS thousands |
| Working capital, net (exclude cash and cash equivalents)                           | (54)  | -   | -   | -   | (30,672)  |
| Investment and long-term loans   | -   | -   | -   | -   | 16,467  |
| Fixed and other assets, net  | 2,557   | -   | -   | -   | 17,672  |
| Long term liabilities  | (2,220)   | -   | -   | -   | (1,254)   |
| Minority interest  | -   | -   | -   | -   | (7,971)   |
| Balance of loans and investments which left at the time of exit from consolidation | -   | -   | -   | -   | (18,080)  |
| Capital gain (loss) on sale or issuance to third party                             | (404)   | -   | -   | -   | 33,059  |
| Proceeds on credit   | -   | -   | -   | -   | (2,532)   |
|  | <b>(121)</b>                                    | <b>-</b>  | <b>-</b>  | <b>-</b>  | <b>6,689</b>                                      |

**Annex E - Companies formerly proportionately consolidated initially fully consolidated**

|  | For the six months ended                           |  | For the three months ended                         |  | For the year ended                                   |
|--|--|--|--|--|--|
|  | June 30<br>2006<br>(Unaudited)<br>NIS<br>thousands | June 30<br>2005<br>(Unaudited)<br>NIS<br>thousands | June 30<br>2006<br>(Unaudited)<br>NIS<br>thousands | June 30<br>2005<br>(Unaudited)<br>NIS<br>thousands | December 31<br>2005<br>(Audited)<br>NIS<br>thousands |
| Working capital, net (exclude cash and cash equivalents) | (2,095)  | 10,294   | (1,031)  | -  | 10,093   |
| Long term debits   | (1,052)  | 211  | -  | -  | 211  |
| Investments and fixed assets, net                        | (132)  | (7,110)  | (132)  | -  | (7,908)  |
| Other assets, net  | (7,811)  | (3,883)  | (7,811)  | -  | (3,883)  |
| Long term liabilities                                    | (3,947)  | 966  | 15   | -  | 1,006  |
| Goodwill created upon acquisition                        | 2,998  | -  | -  | -  | (2,209)  |
| Excess cost upon liabilities                             | 5,357  | -  | -  | -  | -  |
|  | <b>(6,682)</b>                                     | <b>478</b>   | <b>(8,959)</b>                                     | <b>-</b>   | <b>(2,690)</b>                                       |