

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

### **Directors' Report on the Company's State of Affairs As of September 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 nine and three-month periods ended September 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. In addition, the Company and a British investment bank named Shore Capital Finance Limited are presently in the process of founding an investment fund for foreign investors only that will invest in securities traded in Israel and abroad.

**Industry:** - Urdan and the companies it controls are engaged in industry and commerce, focusing on metals, compound 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 2.3.1 below.

**Real Estate and Infrastructures** – The Company operates mainly through the directly and indirectly held investees – Leader Real Estate (2006) Ltd., Polar Real Estate Ltd., Ophir Holdings Ltd., and Citypass Ltd. See Paragraph 2.2.2 below regarding an agreement signed subsequent to balance sheet date by Leader Real Estate with respect to the sale of commercial projects in Germany following which Leader will record a pre-tax gain of NIS 44 million in the fourth quarter of 2006 if the agreement is consummated (the Company's share is NIS 25 million).

**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 manage the 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 subsequent to the reporting period, Leader directly and indirectly 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 a loss of NIS 2.4 million, compared with net income of NIS 63.2 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 balance sheet date, Leader Capital Markets distributed an additional dividend in the amount of NIS 6.4 million and declared a dividend of NIS 7 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\$ 3.9 million and with income of US\$ 1.7 million for the quarter (in view of the decline in the exchange rate of the U.S. dollar, the Sphera Fund lost an amount of NIS 22.0 million during the reporting period and an amount of NIS 10.9 million during the quarter). The net dollar yield in the fund in the reporting period was 3.4%, compared with a 2.8% yield of the Tel-Aviv 100 Index and an increase in the Nasdaq of 2.4%.

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 6.5% and 3.8% decline in the dollar exchange rate during the reporting period and in the third 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.

Leader Capital Markets acquired excess cost in the amount of NIS 7.8 million as a result of the acquisition, which it recorded on its balance sheet under other assets and attributed to intangible assets.

On October 5, 2006 the subsidiary of Leader Capital Markets exercised the aforementioned option in consideration for NIS 6.7 million. Subsequent to exercising the option, the subsidiary of Leader Capital Markets holds 50% of the capital of Yelin-Lapidot. The additional excess cost acquired as a result of exercising the option was also attributed to intangible assets.

Yelin-Lapidot currently manages assets in excess of NIS 4 billion.

## **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 to acquire various parts of rental apartment projects in Germany for a total amount of €130 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 €130 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, in September 2006, additional agreements were signed for the purchase of residential properties containing 340 housing units and 30 stores for an amount of €20 million. Upon the signing of the financing agreement for the purchase of these properties, the bank approved an extension until January 2007 for the gathering of properties up to a total amount of €130 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, net, amounted to €3.2 million as of the publication date of the financial statements after a return on its investment of €81 thousand.

- 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 €10 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 made 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 €10 million. In the reporting period the parties closed on the purchase of 28 commercial properties, which contain shopping centers and supermarkets, at a purchase price (including various acquisition costs) of €10 million, constituting the total and final scope of the transaction.

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

Leader announced that on November 29, 2006, Leader Real Estate and the aforementioned partners had signed a transaction to sell shares they held in a foreign company through which the investment in the aforementioned properties was made for the total price of €133 million payable in cash. The share of Leader Real Estate in the consideration amounts to €13 million.

The transaction is expected to be consummated by the end of 2006, upon which Leader Real Estate anticipates recording in its financial statements a pre-tax gain in the amount of NIS 44 million (the Company's share is NIS 25 million).

- 2.2.3** An investee company of 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. Subsequent to balance sheet date, the investee company of Leader Real Estate received loans in the amount of €7.4 million. The loans were used mainly in order to repay shareholders' loans in the amount of €4.7 million that had been provided by Leader Real Estate.
- 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, 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.

The Subsidiary paid the amount of €7.1 million in consideration of the shares, of which €2 million was financed by a limited partnership in which the limited partners are third parties and the general partner is a company under the control of the Company. The balance was financed by the Company's normal methods of finance, including bank financing.

Furthermore, the Subsidiary is acting to receive bank financing in order to complete the purchase of the real estate owned by the foreign companies. Subsequent to balance sheet date, the Subsidiary provided an additional loan in the amount of €3.0 million as interim financing until the bank financing is received, and it is anticipated to provide another €1.5 million. 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.

The Partnership intends to construct a building which will contain storage and office space, at an estimated total cost of £9 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. As at the date of this Report, Polar International has transferred the amount of £1.2 million on account of the shareholders' equity. The construction is anticipated to begin at the end of 2009 at which time the balance of the shareholders' equity will be transferred.

**2.2.6** 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 (September 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 holding the advance payment 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. Initial hearings were scheduled for October 2006, at which the court deliberated, 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, 83 apartment purchasers exercised this right. Notwithstanding, since that date, the Corporation signed 118 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.

On September 21, 2006 the Attorney General confirmed that the Corporation is in compliance with the conversion procedure of the Harold Tower building into a condominium. The confirmation was provided to the Corporation for a period of six months, unless extended for an additional period by the Corporation.

On June 26, 2006 the seller filed a legal claim against the Corporation alleging the non-payment of rent for the months May-September 2006 in respect of the apartments in the building rented out by the Corporation, and including a demand to vacate 24 apartments on the grounds that the lease agreement had expired. In its reply to the legal claims the Corporation alleges a number of breaches of the lease agreements by the seller. In the court hearings held on the aforementioned claims, the judge ruled that the Corporation would pay rent to the seller as from September in respect of the rent it collects from the lease of apartments in the building to sub-lessees. The Corporation has included a provision on its books in respect of the full rent liabilities for such months.

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.

In August 2006 the Company and Kaldash Construction Ltd. ("Kaldash Construction") purchased part of the rights of the partners in the Canaf partnerships managed by the Company. In consideration for the aforementioned rights, the Company and Kaldash Construction paid the amount of \$ 724 thousand each in consideration for 2% of the rights in the fund for each one of them.

**2.2.7** 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.

**2.2.8** 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, under which it raised the amount of NIS 47 million (before issuance expenses). A subsidiary of Leader Capital Markets was 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.

**2.2.9** The principal meaning of the transactions described above, along with other activities in the real estate and infrastructures segment, is the recording of significant expenses in the short term (mainly financing expenses on loans taken in order to purchase some of the said projects) for the purpose of constructing and enhancing the projects so that they may be sold at a considerable gain in the long term.

## **2.3 Technology and telecommunications segment**

### **2.3.1 Technology**

- A. Technologies concluded the quarter with income of NIS 8.4 million, the highest quarterly income since its incorporation.
- B. 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).

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.

During the reporting period, Technologies sold 516,000 par value ordinary shares of Technologies for a total consideration of NIS 978 thousand. Furthermore, in November 2006 Technologies sold on and off the stock exchange 3,426,670 par value ordinary shares of Technologies for a total consideration of NIS 9,253 thousand.

Following these transactions and additional acquisitions of shares of Technologies on the stock exchange in the reporting period, the Company holds 69% of the capital of Technologies.

- C. 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.
- D. In June 2006, the investment of Art P.A. in Superior Cables Ltd. was consummated – see Note 3.A.10 to the financial statements. The share of Technologies in equity profits recorded by Art P.A. in the quarter in respect of its investment in Superior (including in respect of the inclusion of a negative original difference in the statement of operations) amounted to NIS 6.2 million (the Company's share is NIS 4.7 million).
- E. In the quarter Technologies and the Platinum Fund (a venture capital fund jointly controlled by Technologies) completed the sale of all their holdings in ADT (an affiliated company). As a result of the sale, Technologies recorded a capital gain in the third quarter in the amount of NIS 4.6 million which includes its share as a limited partner in the Platinum Fund (the Company's share is NIS 3.5 million). See also Note 3.A.11 to the financial statements.
- F. 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.

- G. In March 2006, Technologies issued securities pursuant to a prospectus for a public offering as detailed in Note 3.A.3. 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.

- H. During the second 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 is a net income of NIS 3.4 million (the share of the Company – NIS 2.6 million).
- I. The Company and Technologies joined the founding group of Advanced Technology Acquisition Corporation (“ATAC”), a company void of any activity and registered in Delaware, USA. ATAC is interested in registering for trading on an American stock exchange and raising capital as a shell firm, so that it can merge into it the operations of an Israeli or foreign technology company having activity and/or a representative in Israel.

Technologies and the Company purchased shares of ATAC for the price of \$ 2,333 and \$ 1,667, which grant them 9.3% and 4.5% of the capital of ATAC, respectively.

In addition, Technologies and the Company undertook to purchase 933,333 and 466,667 options to entrepreneurs, respectively, at the price of \$ 1 per each option in the framework of a private placement that will take place at the same time as an IPO.

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

**2.3.3** 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" games ("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. In September 2006 YES and the cable companies submitted their response to the request to have the suit approved as a class action. YES contends that the request for approval should be denied as the claim does not fulfill the conditions for being approved as a class action. Based on its legal counsel, at this early stage, YES is unable to assess the chances of the suit.

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

**2.3.5** Subsequent to balance sheet date Polar Communications sold all its shares in Pointer Telocation Ltd. ("Pointer"), which were presented in part as short-term investments and in part as permanent investments on the financial statements of Polar Communications for a total consideration of NIS 16 million.

The overall consideration from the sale of investments in marketable securities subsequent to balance sheet date by Polar Communications (including Pointer as aforementioned) amounted to NIS 24 million and the gain (before tax) of Polar Communications amounted to NIS 6 million.

**2.3.6** Subsequent to balance sheet date, Storeage announced the sale of all the company's shares to a foreign company for the price of \$ 50 million. Polar Communications holds Storeage through Koonras (a wholly owned subsidiary of Polar Communications) and it anticipates receiving NIS 16 million in the fourth quarter of 2006 in respect of its share in Storeage. Furthermore, Ophir Tech (an affiliated company 42% held by Polar Communications) anticipates receiving NIS 15 million in respect of its share in Storeage.

## **2.4 Trade and services segment**

**2.4.1** In January 2006, Polar Communications (through a 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.

Subsequent to balance sheet date, in November 2006, Telit announced that it is conducting negotiations with potential investors regarding a possible investment in its capital.

- 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 regarding restrictive business practices ("the Claim").

On the date it was signed, the parties submitted the Compromise Agreement for approval to the District Court, which scheduled a procedural hearing on the matter that was postponed following the request of the Attorney General who requested an extension in order to examine the question of his participation in the proceeding. The court also accepted the request of the Consumer Council to grant it an extension for providing its opinion to the Compromise Agreement and to grant it permission to read the file.

On September 10, 2006 the Attorney General submitted to the District Court his opinion by which the Compromise Agreement should not be approved. The plaintiffs and the defendants are presently in the process of discussing a compromise that will be agreeable to the Attorney General.

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 reporting period, 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.

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 million 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 shareholders' loans together with options exercisable for share capital of EER (at a company value for EER of \$80 million), with a request that these shareholders' loans be converted into 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.

In the third quarter one of the shareholders of EER invested an additional \$0.5 million in return for 0.8% of the latter's 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 7.9%, 18.2%, and 3.2% 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.

Subsequent to balance sheet date, Urdan, the Company and Technologies provided a bridging loan to EER in the amount of \$ 0.5 million according to their proportionate share in the share capital of EER. The loan bears annual interest of Libor+2.5%.

In addition, subsequent to balance sheet date EER requested from a bank short-term credit of up to \$ 2.5 million, for the purpose of completing the construction of a facility for the implementation of EER's technology for the handling and disposal of solid waste, for continuing its business development and for repaying the bridging loan it received as aforementioned.

Subsequent to balance sheet date EER received bank credit in the amount of \$ 1 million that is secured by guarantees so that the total amount of the bank credit received by EER that is secured by guarantees amounts to \$ 2 million.

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

**2.5.3** On October 17, 2006 a notice was received from the Commissioner of Restrictive Trade Practices ("the Commissioner") in which she expressed her objection to the purchase of Anbar's major operations by Orlight Industries (1959) Ltd. ("Orlight"; a wholly owned subsidiary of Urdan) in accordance with an agreement from June 29, 2006 between Orlight and 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 engaged in the manufacture and marketing of reinforced polyester products, including distribution boxes, insulation boards and lighting fixtures.

Consummation of the agreement was contingent upon the fulfillment of a number of pre-conditions, including the approval of the Commissioner, which as aforementioned was not received.

Anbar published an invitation to make offers by November 22, 2006 to purchase Anbar and/or its operations and assets and/or its shares (an acquisition that requires, inter alia, the permission of the Nazareth District Court) and it is considering its next actions accordingly.

- 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".
- 2.5.5** Soon after an article was published on September 28, 2006 in the Globes newspaper regarding the Merkava tank, Urdan announced in response that it did not receive any notice from the Ministry of Defense regarding future orders from Urdan of the Merkava tank and/or other armored combat vehicles as from the end of 2008 – which is the end of the multi-annual agreement from August 2003 between the Ministry of Defense and Urdan (“the steel agreement”), which was signed following previous agreements and understandings between the parties, and by which for tens of years the Ministry of Defense has purchased certain steel castings manufactured by the foundry of Urdan in Netanya (“the foundry”).

On this matter, attention was called to the response of the IDF Spokesperson that was quoted at the end of the aforementioned article by which, inter alia, the total amount of manufacturing would be determined in discussions regarding the multi-annual plan and that, in the words of the IDF Spokesperson, the IDF and the Tank Administration are presently working together on the required mix of armored combat vehicles.

Nevertheless and as reported in Paragraph 2.4.1.1 of the description of Urdan’s business in the periodic report of Urdan for 2005, there were and there still are uncertainties regarding the extension of the steel agreement in general or its extension to an extent and/or under such circumstances that it will not be worthwhile to continue operating the foundry because of, inter alia, the changing strategic developments in the deployment of ground forces in Israel and around the world, including doubts regarding continuation of the Merkava tank project on which the operations of the foundry, which constitutes the principal activity of Urdan in the metals segment, are based.

According to the aforementioned uncertainty, non-extension of the steel agreement from 2008 or its extension to an extent and/or under such circumstances that it will not be worthwhile to continue operating the foundry in its present format, may have an adverse effect on the results of operations or Urdan as from that date onward. Nonetheless, Urdan believes that if after 2008 it has to close down the foundry this will not involve material costs.

## **2.6 Digital printing segment**

Further to that described in the periodic report for 2005 regarding a claim that was filed against Nipson in a German court alleging the violation of six patents, Nipson reported that the plaintiff had filed an appeal against the proceeding canceling one of the patents that had been won by Nipson. A hearing is scheduled to take place in January 2007 on the proceeding for the cancellation of another patent that had been filed by Nipson. Furthermore, Nipson won the appeal that had been filed by the plaintiff regarding a ruling that had been made against it in the first instance with respect to one of the patents. In other appeals regarding rulings made in the first instance regarding two patents the appeals court decided to appoint another examiner who will submit a technical report on the matter. As regards three other patents the court has either not yet published its ruling or has postponed the hearings until the appeal court decides on the cancellation proceedings.

## **2.7 Additional events**

**2.7.1** 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, it agrees to the annual bonus being reduced to 5% (instead of 7.5%) 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, 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.

**2.7.2** Mr. Yair Fudim, a director and the 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, it agrees to the annual bonus being 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, a director and the 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.

- 2.7.3** 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, 2006, 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 Investments, by way of rights through the sales offer, most of the securities offered for a total amount of NIS 140 million. Under the terms of the underwriting agreement, the balance of the offered securities was 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 purchases of 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 116 million as of the balance sheet date. Leader has obtained bank financing for most of this acquisition.

- 2.7.4** 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%.

- 2.7.5** 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.

In the reporting period 529,167 non-marketable options that had been allotted to officers and employees of Leader lapsed.

The effective shareholding rate of the Company in Leader after the above conversions is 57.5%.

- 2.7.6** In May 2006, the Company signed an agreement with Silberbaum Holdings Ltd. ("Silberbaum"), whereby it sold 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. In addition, Silberbaum transferred 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.
- 2.7.7** See Notes 3.B.4.h. and 3.B.3. to the financial statements regarding the employment agreements of the chairman of the board of the Urdan and Polar Investments.
- 2.7.8** On November 26, 2006 the audit committee and board of directors of Polar Communications approved an engagement for the receipt of management and consultation services (hereinafter – "the agreement") from the Company.

Subject to approval by the general shareholders' meeting of Polar Communications, the engagement according to the agreement will come into effect on January 1, 2007 and will be in effect for a period of 5 years. When the aforementioned agreement comes into effect a similar engagement with Polar Investments according to an agreement signed in 1999 will be terminated.

According to the agreement, Polar Investments shall pay the Company in consideration of the management and consultation services the amount of NIS 1 million per year, linked to the CPI and payable in four quarterly payments.

- 2.7.9** Proximate to the date of publishing the financial statements, Gmul Investment Company Ltd. (an interested party of Polar Investments) attached a valuation of Polar Investments to its financial statements for September 30, 2006.

In accordance with the aforementioned valuation, the value of Polar Investments is between NIS 422 million and NIS 448 million.

### 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 September 2006:

	As of September 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	2,055.0	110.6	107.4	145.7
Investments and loans in investee (affiliated) and other companies	862.0	335.1	302.9	296.7
Real estate	542.2	-	-	-
Fixed assets	599.3	22.7	24.3	25.2
Other assets and deferred expenses	151.4	-	1.6	4.1
<b>Total assets</b>	<b>4,209.9</b>	<b>468.4</b>	<b>436.2</b>	<b>471.7</b>
Current liabilities	1,360.3	55.6	54.0	85.3
Long-term liabilities	1,856.9	165.7	132.8	102.1
Minority interest	726.7	-	2.3	6.0
Convertible debentures	-	-	-	11.7
Receipts on account of options issued in subsidiaries	18.9	-	-	-
Shareholders' equity	247.1	247.1	247.1	266.6
<b>Total liabilities and shareholders' equity</b>	<b>4,209.9</b>	<b>468.4</b>	<b>436.2</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 247.1 million as of September 30, 2006, compared with NIS 266.6 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 losses of NIS 2.4 million, a dividend in the amount of NIS 14.4 million that was paid by the Company during the reporting period and the self purchase of shares of the Company in the amount of NIS 2.5 million.
- Current assets totaled NIS 107.4 million as of September 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 302.9 million at the end of September 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 6.6 million (mainly Technologies) 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 shares of Leader on the stock exchange and shares of Technologies from Marubeni, as described previously.
- The financial liabilities of the Company and the private companies it controls totaled NIS 186.6, 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 September 2006, net of liquid resources, total NIS 79 million.

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

##### **General**

The Company ended the reporting period with a loss of NIS 2.4 million, compared with income of NIS 63.2 million in the same period last year, and a loss of NIS 4.7 million in the quarter, compared with income of NIS 8.2 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 September 2006):**

	<b>Nine months 2006</b>	<b>Nine months 2005</b>	<b>Quarter 3 2006</b>	<b>Quarter 3 2005</b>
Revenues from consultancy, management and participation in income of funds	25.5	34.9	7.0	11.5
Income from long-term investments, net	4.7	6.6	-	1.7
Gain from marketable securities, net	1.0	14.0	2.0	6.3
Total costs and other expenses	(26.0)	(31.7)	(7.7)	(8.7)
<b>Income before financing, net</b>	<b>5.2</b>	<b>23.8</b>	<b>1.3</b>	<b>10.8</b>
Financing expenses, net	(8.4)	(7.9)	(2.9)	(3.0)
<b>Income (loss) after financing expenses, net</b>	<b>(3.2)</b>	<b>15.9</b>	<b>(1.6)</b>	<b>7.8</b>
Taxes on income	(0.9)	(0.3)	(0.2)	(0.2)
Company's share in results of investees	6.6	**54.9	(1.8)	3.1
Loss on decrease in percentage held	(1.3)	-	-	-
Minority interest in results of subsidiaries, net	(3.6)	(7.3)	(1.1)	(2.5)
<b>Net income (loss) for the period</b>	<b>(2.4)</b>	<b>**63.2</b>	<b>(4.7)</b>	<b>8.2</b>

(\*) 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 25.5 million, compared with NIS 34.9 million in the same period last year. Total revenues for the quarter amounted to NIS 7.0 million, compared with NIS 11.5 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 2.0 million, respectively, compared with income of NIS 14.0 million and NIS 6.3 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 increased by 2.8% in the reporting period, compared with an increase of 18.5% in the same period last year.
- The Company's share in the income of investees in the reporting period amounted to NIS 6.6 million and derives mainly from the Company's share in the income of Technologies (NIS 54.9 million in the same period last year mainly due to the share of the Company in the income of Leader) and in the third quarter of 2006, amounted to a loss of NIS 1.8 million (in the same quarter last year – income of NIS 3.1 million) and derives mainly from the Company's share in the income of Leader.
- Total costs and other expenses amounted to NIS 26.0 million in the first nine months of 2006, compared with NIS 31.7 million in the same period of 2005. Total costs and expenses in the quarter amounted to NIS 7.7 million, compared with NIS 8.7 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 third quarter amounted to NIS 8.4 million and NIS 7.9 million, respectively, compared with NIS 2.9 million and NIS 3.0 million in the same periods last year. The increase in financing expenses in the reporting period is due mainly to the income from loans granted to an affiliated company being lower than in the same period last year, and to the decrease in the exchange rate of the dollar in the reporting period as compared with its increase in the same period last year.

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

Revenues from sales, services, consultancy, management and underwriting in the Group's consolidated financial statements totaled NIS 1,425.0 million and NIS 467.6 million in the reporting period and the quarter, respectively, compared with NIS 1,403.5 million and 477.6 million in the same periods last year, respectively.

The main changes in the composition of the revenues between the periods are as follows: an increase in the sales of Telit in the telecommunications and technology segment, an increase in the revenues from paints and insulation products in the industry segment and an increase in the revenues from the digital printing segment, which were offset by a decrease in revenues as a result of the decrease in revenues of Polar Real Estate following conclusion of the Herzliya apartment project and the removal of Maximedia from consolidation in Polar Communications beginning from 2006.

Income from long-term investments and assets, etc., net, totaled NIS 73.1 million and NIS 5.7 million in the reporting period and the quarter, respectively, compared with NIS 333.8 million and NIS 65.8 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 mainly due 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 Europe and the gain from the realization of the balance of the Company's holdings in DS Securities.

Consolidated financing expenses amounted to NIS 122.7 million and NIS 42.1 million in the reporting period and the quarter, respectively, compared with NIS 104.8 million and NIS 40.4 million in the same periods last year, respectively. The increase in financing expenses derives mainly from the issuance of CPI-linked debentures in 2005 by the Company, Leader and Polar Communications, the decrease in yields on dollar-linked deposits of Polar Communications as a result of the decrease in the exchange rate of the dollar, financing expenses on mortgages taken in order to purchase projects in the USA in Polar International and the financing expenses of Leader Real Estate.

The business results of the Company were adversely affected by the losses of the investee companies Polar Investments and Polar Communications.

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

	Nine months 2006	Nine months 2005	Quarter 3 2006	Quarter 3 2005
Revenues from sales, services, , consultancy, management and underwriting	1,425	1,403.5	467.6	477.6
Income from long-term investments and assets, etc., net	73.1	333.8	5.7	65.8
Gain from marketable securities, net	21.6	45.8	7.7	21.8
Company's share in income of investees, net	9.5	-	7.4	-
<b>Total revenues</b>	<b>1,529.2</b>	<b>1,783.1</b>	<b>488.4</b>	<b>565.2</b>
Cost of sales and services	1,073.4	1,064.6	359.7	377.6
Selling and marketing expenses	172.7	148.5	58.3	50.9
General and administrative expenses	181.6	(*) 213.7	58.9	66.0
Company's share in losses of investees, net	-	14.2	-	3.2
Financing expenses, net	122.7	104.8	42.1	40.4
<b>Total expenses</b>	<b>1,550.4</b>	<b>1,545.8</b>	<b>519.0</b>	<b>538.1</b>
<b>Income (loss) before income taxes</b>	<b>(21.2)</b>	<b>237.3</b>	<b>(30.6)</b>	<b>27.1</b>
Income taxes	(15.7)	(71.2)	(3.6)	(12.2)
<b>Income (loss) after income taxes</b>	<b>(36.9)</b>	<b>166.1</b>	<b>(34.2)</b>	<b>14.9</b>
Minority interest in results of subsidiaries, net	33.9	(102.9)	29.5	(6.7)
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>(2.4)</b>	<b>(*) 63.2</b>	<b>(4.7)</b>	<b>8.2</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 11.2 million. These flows derived mainly from the losses of the Company, which were partly 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 investing activities, net, in the reporting period amounted to NIS 1.6 million. These flows were used mainly for the long-term investment of NIS 19 million in investees and other companies, net, which was offset by the amount of NIS 10 million received in consideration of marketable securities and proceeds from the sale of long-term investments.

Cash flows used in financing activities totaled NIS 25.7 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 2.5 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 79 million as at September 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 4.35 to 4.37 to the dollar. The fair value is a loss of NIS 71 thousand.

The aforementioned transactions are for a period ending on February 28, 2007. The maximum derivatives position of the subsidiary of Urdan in the reporting period was on April 30, 2006, in call options to purchase \$2.5 million. These transactions were for hedging purposes.

Another subsidiary of Urdan did not have any open forward transactions as at September 30, 2006. The maximum position of this subsidiary in the reporting period was in April 2006 when it had forward transactions to purchase dollars for hedging purposes in the total amount of NIS 19.8 million.

Polar Investments' maximum derivatives position in the reporting period was between January 1, 2006 and 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 the quarter Technologies executed a forward transaction to purchase \$ 5 million and recorded an immaterial gain on this transaction. As at the date of this Report Technologies does not have any open transactions on the derivatives market.

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 at September 30, 2006, the Company has open forward transactions for the purchase of \$2.5 million for an amount of NIS 11.8 million. In the reporting period, the Company carried out additional transactions for the purchase of \$7.5 million for an amount of NIS 33.5 million and for the purchase of €2 million for an amount of \$ 2.5 million. These transactions had no material impact on the results of operations of the Company for the reporting period.

As of the Report date, Leader does not have 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 derivative financial 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 Risks 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 part of 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 326 thousand and NIS 1,826 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 on 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 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 millions)

	<u>Unlinked</u>	<u>Linked to the CPI</u>	<u>Linked to foreign currency (*)</u>	<u>Other / Non- monetary balances</u>	<u>Total</u>
<b>As of September 30, 2006</b>					
<b>Assets</b>					
Cash and cash equivalents	182.5	1.0	126.3	-	309.8
Marketable securities	160.5	3.0	178.2	0.6	342.3
Short-term deposits and investments	189.0	16.0	25.3	-	230.3
Current maturities and loans granted	11.0	13.3	-	-	24.3
Trade accounts receivable	379.6	-	169.3	-	548.9
Accounts receivable and other debit balances	64.6	10.6	58.3	28.0	161.6
Inventory and work in progress	-	-	-	437.8	437.8
Real estate	-	-	-	542.2	542.2
Long-term investments in investee and other companies	48.7	22.7	133.2	567.7	772.3
Long-term deposits and loans granted	16.1	15.8	57.8	-	89.7
Fixed assets, net	-	-	-	599.3	599.3
Other assets and deferred expenses	-	-	-	151.4	151.4
<b>Total assets</b>	<b>1,052.1</b>	<b>82.4</b>	<b>748.4</b>	<b>2,327.0</b>	<b>4,209.9</b>
<b>Liabilities</b>					
Credit from banks and others	319.0	218.4	161.4	-	698.8
Trade accounts payable	122.5	10.0	119.8	0.4	252.7
Accounts payable and other credit balances	140.2	48.5	49.1	43.3	281.1
Advances from customers	19.0	-	-	108.8	127.8
Long-term liabilities to banks and others	324.8	489.4	224.3	-	1,038.5
Debentures	-	578.1	60.8	-	638.9
Convertible debentures	-	122.9	30.3	-	153.2
Liability for severance pay, net	-	-	-	15.6	15.6
Deferred taxes	-	-	-	10.6	10.6
<b>Total liabilities</b>	<b>925.5</b>	<b>1,467.3</b>	<b>645.7</b>	<b>178.7</b>	<b>3,217.2</b>
Minority interest	-	-	-	726.6	726.6
Receipts on account of options issued in subsidiaries	-	-	-	19.0	19.0
Shareholders' equity	-	-	-	247.1	247.1
	-	-	-	992.7	992.7
	<b>925.5</b>	<b>1,467.3</b>	<b>645.7</b>	<b>1,171.4</b>	<b>4,209.9</b>
	<b>126.6</b>	<b>(1,384.9)</b>	<b>102.7</b>	<b>1,155.6</b>	<b>-</b>

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

	<u>Unlinked</u>	<u>Linked to the CPI</u>	<u>Linked to foreign currency (*)</u>	<u>Other / Non- monetary 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	**54.8	-	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 balances	59.3	26.2	44.8	12.8	143.1
Inventory and work in progress	-	-	-	366.3	366.3
Real estate	-	-	-	634.1	634.1
Long-term investments in investee and 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>948.7</b>	<b>286.5</b>	<b>631.0</b>	<b>2,428.2</b>	<b>4,294.4</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 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
Liability for severance pay, net	0.8	-	-	12.2	13.0
Deferred taxes	-	-	-	10.8	10.8
<b>Total liabilities</b>	<b>1,171.3</b>	<b>1,515.5</b>	<b>561.7</b>	<b>33.8</b>	<b>3,282.3</b>
Minority interest	-	-	-	***717.5	717.5
Receipts on account of options issued in subsidiaries	1.8	-	-	***14.5	16.3
Convertible debentures (quasi-equity)	-	-	-	11.7	11.7
Shareholders' equity	-	-	-	266.6	266.6
	1.8	-	-	1,010.3	1,012.1
	<b>1,173.1</b>	<b>1,515.5</b>	<b>561.7</b>	<b>1,044.1</b>	<b>4,294.4</b>
	<b>(224.4)</b>	<b>(1,229.0)</b>	<b>69.3</b>	<b>1,384.1</b>	<b>-</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: November 30, 2006

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

	<b>September 30 2006</b>	<b>September 30 2005</b>	<b>December 31 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	309,830	687,959	*554,989
Deposits and short-term investments	230,301	64,349	*57,243
Marketable securities	342,252	387,305	449,732
Current maturities and loans receivable	24,288	16,020	14,896
Trade receivables	548,872	540,558	555,417
Other receivables	161,619	159,384	143,109
Inventory and work-in-process	437,817	332,572	366,287
	<b>2,054,979</b>	<b>2,188,147</b>	<b>2,141,673</b>
<b>Real estate</b>	<b>542,248</b>	<b>573,491</b>	<b>634,111</b>
<b>Investments and long-term loans</b>			
Investments in investee and other companies	772,316	653,460	622,154
Loans and deposits	89,652	104,427	114,415
	<b>861,968</b>	<b>757,887</b>	<b>736,569</b>
<b>Fixed assets</b>	<b>599,278</b>	<b>652,361</b>	<b>646,574</b>
<b>Other assets and deferred expenses</b>	<b>151,420</b>	<b>125,925</b>	<b>135,401</b>
	<b>4,209,893</b>	<b>4,297,811</b>	<b>4,294,328</b>
<b>Current liabilities</b>			
Credit from banks and others	698,778	838,563	869,677
Suppliers and service providers	252,668	230,715	241,005
Accounts payable and credit balances	281,120	*316,230	279,799
Customer deposits	127,756	49,728	98,212
	<b>1,360,322</b>	<b>1,435,236</b>	<b>1,488,693</b>
<b>Long-term liabilities</b>			
Credit from banks and others	1,038,337	1,049,432	1,048,030
Debentures	638,928	543,781	571,945
Debentures convertible into shares	153,355	259,547	149,692
Employee retirement benefit, net	15,632	16,865	13,030
Deferred taxes	10,599	9,200	10,821
	<b>1,856,851</b>	<b>1,878,825</b>	<b>1,793,518</b>
<b>Minority interest</b>	<b>726,627</b>	<b>*677,863</b>	<b>** 717,315</b>
<b>Receipts from share options issued by subsidiaries</b>	<b>18,945</b>	<b>19,470</b>	<b>**16,543</b>
<b>Debentures convertible into company shares</b>	<b>-</b>	<b>11,715</b>	<b>11,727</b>
<b>Shareholders' equity</b>	<b>247,148</b>	<b>*274,702</b>	<b>** 266,532</b>
	<b>4,209,893</b>	<b>4,297,811</b>	<b>4,294,328</b>

\* Reclassified

\*\* Restated

Date of approval: November 30, 2006

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

	<b>For the nine months ended</b>		<b>For the three months ended</b>		<b>For the year ended</b>
	<b>September 30</b>	<b>September 30</b>	<b>September 30</b>	<b>September 30</b>	<b>December 31</b>
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>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>Income</b>					
Income from sales, services, consulting, management and underwriting	<b>1,425,009</b>	* 1,403,533	<b>467,591</b>	* 477,621	1,903,522
Gain on marketable securities, net	<b>21,570</b>	45,818	<b>7,683</b>	21,831	66,779
Gain on sales of investments, loans and assets, net	<b>73,115</b>	333,837	<b>5,752</b>	65,708	357,164
Company's equity in earnings of investment, net	<b>9,541</b>	-	<b>7,363</b>	-	-
	<b>1,529,235</b>	1,783,188	<b>488,389</b>	565,160	2,327,465
<b>Costs and expenses</b>					
Cost of sales and services	<b>1,073,391</b>	1,064,638	<b>359,658</b>	377,574	*1,465,537
Selling and marketing	<b>172,680</b>	148,511	<b>58,333</b>	50,902	202,650
General and administrative	<b>181,646</b>	* 213,644	<b>58,934</b>	* 66,041	268,800
Company's equity in loss of investment, net	-	14,216	-	3,118	21,942
Financing expenses, net	<b>122,703</b>	104,846	<b>42,074</b>	40,392	160,983
	<b>1,550,420</b>	1,545,855	<b>518,999</b>	538,027	2,119,912
<b>Earnings (losses) before taxation income</b>					
	<b>(21,185)</b>	237,333	<b>(30,610)</b>	27,133	207,553
Taxes on income	<b>(15,779)</b>	* (71,235)	<b>(3,592)</b>	(12,210)	*(67,833)
<b>Earnings (losses) from operations after taxes on income</b>					
	<b>(36,964)</b>	166,098	<b>(34,202)</b>	14,923	139,720
Minority interest in earnings of subsidiaries, net	<b>33,923</b>	*(102,899)	<b>29,505</b>	(6,739)	*(81,303)
<b>Earnings (losses) before cumulative effect</b>					
	<b>(3,041)</b>	63,199	<b>(4,697)</b>	8,184	58,417
Cumulative effect as at beginning of period of change in accounting principles, net	<b>619</b>	-	-	-	-
<b>Net earnings (losses) for the period</b>	<b>(2,422)</b>	63,199	<b>(4,697)</b>	8,184	58,417
<b>Net earnings (losses) per share*</b>					
Basic earnings (losses) per share:					
Earnings (losses) before cumulative effect	<b>(0.16)</b>	3.46	<b>(0.26)</b>	0.45	3.20
Earnings from cumulative effect as at beginning of period of change in accounting principles, net	<b>0.03</b>	-	-	-	-
<b>Net earnings (losses)</b>	<b>(0.13)</b>	3.46	<b>(.26)</b>	0.45	3.20
Diluted earnings (losses) per share:					
Earnings (losses) before cumulative effect	<b>(0.20)</b>	3.07	<b>(0.26)</b>	0.38	2.39
Earnings from cumulative effect as at beginning of period of change in accounting principles, net	<b>0.03</b>	-	-	-	-
<b>Net earnings (losses)</b>	<b>(0.17)</b>	3.07	<b>(0.26)</b>	0.38	2.39

\* 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
	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>
<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>Nine month period ended September 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	-	-	-	-	-	(2,457)	-	-	(2,457)
Conversion of employee options into shares of the Company	117	(117)	-	-	-	-	-	-	-
Dividend	-	-	-	-	-	-	(14,379)	-	(14,379)
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	-	(2,213)	-	-	-	-	(2,213)
Capital reserves of investee company	-	164	-	-	-	-	-	-	164
Repayment of loans to employee for purchase of shares	-	-	-	-	37	-	-	-	37
Issue of warrants	-	-	64	-	-	-	-	-	64
Losses for the period	-	-	-	-	-	-	-	(2,422)	(2,422)
<b>Balance as at September 30, 2006 (Unaudited)</b>	<b>25,665</b>	<b>166,586</b>	<b>3,857</b>	<b>(2,315)</b>	<b>(1,162)</b>	<b>(9,757)</b>	<b>-</b>	<b>64,278</b>	<b>247,148</b>

\* Initial implementation of accounting standards

\*\* Reclassified

**Statements of Changes in Shareholders' Equity (cont'd)****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
	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>
<b>Balance as at January 1, 2005 (Audited)</b>	25,360	164,850	-	8,670	(3,194)	(2,451)	30,559	223,794
<b>Nine month period ended September 30, 2005 (Unaudited)</b>								
Issuance of options	-	-	3,201	-	-	-	-	3,201
Purchase of company shares	-	-	-	-	-	(2,292)	-	(2,292)
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	-	-	-	(7,455)	-	-	-	(7,455)
Net earnings for the period	-	-	-	-	-	-	* 63,199	*63,199
<b>Balance as at September 30, 2005</b>	<u>25,548</u>	<u>166,053</u>	<u>3,201</u>	<u>1,215</u>	<u>(1,199)</u>	<u>(4,743)</u>	<u>84,627</u>	<u>274,702</u>

\* Restated.

**Statements of Changes in Shareholders' Equity (cont'd)****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	Total profit and loss	Total
	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>
<b>Balance as at July 1, 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>
<b>Three month period ended September 30, 2006 (unaudited)</b>								
Purchase of Company shares	-	-	-	-	-	<b>(1,078)</b>	-	<b>(1,078)</b>
Conversion of employee options into shares of the Company	<b>2</b>	<b>(2)</b>	-	-	-	-	-	-
Adjustments from the translation of financial statements of autonomous foreign investee	-	-	-	<b>(2,354)</b>	-	-	-	<b>(2,354)</b>
Losses for the period	-	-	-	-	-	-	<b>(4,697)</b>	<b>(4,697)</b>
<b>Balance as at September 30, 2006</b>	<b>25,665</b>	<b>166,586</b>	<b>3,857</b>	<b>(2,315)</b>	<b>(1,162)</b>	<b>(9,757)</b>	<b>64,274</b>	<b>247,148</b>

**Statements of Changes in Shareholders' Equity (cont'd)****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	Total profit and loss	Total
	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>	<u>NIS thousands</u>
<b>Balance as at July 1, 2005 (Unaudited)</b>	25,548	166,053	3,201	2,081	(1,199)	(2,834)	76,443	269,293
<b>Three month period ended September 30, 2005 (unaudited)</b>								
Purchase of Company shares	-	-	-	-	-	(1,909)	-	(1,909)
Adjustments from the translation of financial statements of autonomous foreign investee	-	-	-	(866)	-	-	-	(866)
Net earnings for the period	-	-	-	-	-	-	8,184	8,184
<b>Balance as at September 30, 2005</b>	<u>25,548</u>	<u>166,053</u>	<u>3,201</u>	<u>1,215</u>	<u>(1,199)</u>	<u>(4,743)</u>	<u>84,627</u>	<u>274,702</u>

**Statements of Changes in Shareholders' Equity (cont'd)****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	Loans to employees for purchase of shares	Company shares held by the Company and subsidiary	Dividend declared subsequent to balance sheet date	Retained 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 nine months ended		For the three months ended		For the year ended
	September 30 2006	September 30 2005	September 30 2006	September 30 2005	December 31 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)	(2,422)	*63,199	(4,697)	8,184	* 58,417
Adjustments required to reconcile cash from operating activities (Annex A)	14,989	*(91,082)	(17,699)	(57,684)	*(102,222)
Net cash inflow (outflow) from operating activities	12,567	(27,883)	(22,396)	(49,500)	(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	(50,360)	(161,963)	(21,641)	(20,814)	** (230,642)
Proceeds from sale of fixed assets and other assets	32,095	110,533	9,727	67,377	** 110,523
Proceeds from sale of marketable securities, short-term investments and deposits, net	(14,920)	(138,611)	(53,698)	(16,585)	(159,711)
Investments in investee and other companies (including through loans and capital notes), net	(223,890)	(98,597)	(62,027)	(25,741)	(128,333)
Decrease in deposits and loans granted, net	8,183	(18,849)	(5,647)	(5,665)	** (60,418)
Proceeds from sale of investment in investee and other companies	181,663	383,630	25,221	26,848	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	-	-	(2,690)
Company consolidated for the first time (Annex F)	(30,470)	-	-	-	-
Net cash inflow (outflow) from investment activities	(104,502)	76,621	(108,065)	25,420	11,960

\* Restated

\*\* Reclassified

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

	For the nine months ended		For the three months ended		For the year ended
	September 30	September 30	September 30	September 30	December 31
	2006	2005	2006	2005	2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
<b>Cash flows from financing activities:</b>					
Purchase of company shares by subsidiary	(2,457)	(2,292)	(1,078)	(1,909)	(4,849)
Issuance of debentures and convertible debentures (net of issuance expenses) into shares of the Company	-	67,912	-	-	67,912
Dividend to minority in subsidiaries	(38,018)	(35,278)	(3,914)	(1,491)	(35,277)
Receipt (repayment) of loans and capital notes, net	(125,472)	(221,744)	(28,214)	4,109	(238,869)
Issuance of marketable securities of subsidiaries	56,662	781,757	9,824	85,983	725,081
Sale of debentures held by subsidiary to third parties	14,183	-	14,183	-	-
Receipt (repayment) of short-term credit, net	26,964	(88,701)	50,903	5,241	(52,963)
Repayment of debentures and convertible debentures in consolidated companies	59,717	-	-	-	63,479
Issuance of options	-	3,201	-	-	3,201
Repayment of convertible debentures in subsidiaries	(137,299)	(61,715)	-	-	(131,989)
Repayment of loans for purchase of shares	37	1,995	-	-	1,995
Dividend	(14,379)	(9,131)	-	-	(9,131)
Issuance of rights of a proportionately consolidated partnership (Annex G)	6,718	-	6,718	-	-
<b>Net cash inflow (outflow) from financing activities</b>	<b>(153,344)</b>	<b>436,004</b>	<b>48,422</b>	<b>91,933</b>	<b>388,590</b>
<b>Translation differences with respect to cash balances with respect to cash balances in autonomous investee companies</b>	<b>120</b>	<b>(8,154)</b>	<b>(2,302)</b>	<b>(5,551)</b>	<b>(13,127)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(245,159)</b>	<b>476,588</b>	<b>(84,341)</b>	<b>62,302</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>394,171</b>	<b>625,657</b>	<b>211,371</b>
<b>Balance of cash and cash equivalents at end of period</b>	<b>309,830</b>	<b>687,959</b>	<b>309,830</b>	<b>687,959</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 nine months ended		For the three months ended		For the year ended
	September 30 2006	September 30 2005	September 30 2006	September 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
<b>Income and expenses not involving cash flows:</b>					
Depreciation and amortization	37,441	*59,693	13,400	33,613	78,033
Company's equity in losses (earnings) of investee companies less of dividend received, net	(9,186)	17,041	(6,868)	3,955	* 26,974
Minority interest in results of subsidiaries, net	(33,923)	*102,899	(29,505)	6,739	* 81, 303
Loss (gain) on marketable securities and deposits, net	(18,315)	(49,317)	(1,330)	(23,964)	(56,703)
Expenses (income) from financing activities	29,114	20,654	5,998	13,358	27,405
Deferred taxes, net	3,853	46,235	208	9,812	42,011
Increase (decrease) in liability for employee severance benefits, net	2,708	(542)	710	(1,478)	(3,450)
Gain on sale and amortization of investments and assets, net	(45,634)	(343,076)	(2,682)	(75,233)	(366,166)
Expenses from issuance of employee options, net	1,064	-	191	-	* 597
Cumulative effect as at beginning of period of change in accounting principles, net	(619)	-	-	-	-
<b>Changes in asset and liability items</b>					
Increase in trade receivables and other receivables	(12,488)	*(2,832)	(27,809)	(39,069)	(23,393)
Decrease (increase) in inventory and in land business inventory holdings, net	43,994	13,078	6,458	18,710	(23,869)
Increase (decrease) in suppliers and service providers	16,980	*45,085	23,530	(4,127)	* 115,036
	<b>14,989</b>	<b>(91,082)</b>	<b>(17,699)</b>	<b>(57,684)</b>	<b>(102,222)</b>

\* Restated

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

	For the nine months ended		For the three months ended		For the year ended
	September 30 2006 (Unaudited) NIS thousands	September 30 2005 (Unaudited) NIS thousands	September 30 2006 (Unaudited) NIS thousands	September 30 2005 (Unaudited) NIS thousands	December 31 2005 (Audited) NIS thousands
Conversion of convertible bonds into Company shares	-	1,391	-	-	1,391
Liability to invest in other companies	175	-	-	-	84
Repayment of loan granted in the past against additional shares in subsidiary	1,280	-	1,280	-	-
Purchase of fixed assets on credit	2,095	-	1,304	-	1,468
Sale on credit of fixed assets, land and rental building	49	10,397	-	-	10,438
Conversion of debentures into shares of subsidiary	11,862	12,129	297	834	* 38,686
Dividends payables in respect of subsidiary	38,816	-	-	-	-

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

	For the nine months ended		For the three months ended		For the year ended
	September 30 2006 (Unaudited) NIS thousands	September 30 2005 (Unaudited) NIS thousands	September 30 2006 (Unaudited) NIS thousands	September 30 2005 (Unaudited) NIS thousands	December 31 2005 (Audited) NIS thousands
<b>Assets and liabilities of the subsidiaries as at date of consolidation</b>					
Working capital, net (excluding cash and cash equivalents)	-	-	-	-	1,279
Excess cost	-	-	-	-	(10,502)
Balance of investment in companies as at date of initial consolidation	-	-	-	-	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 nine months ended		For the three months ended		For the year ended
	September 30 2006	September 30 2005	September 30 2006	September 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Working capital, net (excluding 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	-	-	-	-	33,059
Proceeds on credit	(404)	-	-	-	(2,532)
	<b>(121)</b>	-	-	-	6,689

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

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

**Consolidated Statements of Cash Flows (cont'd)****Reported amounts****Annex F - Companies consolidated for the first time**

	For the nine months ended		For the three months ended		For the year ended
	September 30 2006	September 30 2005	September 30 2006	September 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Working capital, net (excluding cash and cash equivalents)	(6,497)	-	-	-	-
Fixed assets	(1,874)	-	-	-	-
Other assets	(23,970)	-	-	-	-
Minority	12,321	-	-	-	-
	<u>(30,470)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

**Annex G – Issuance of rights to partners of a proportionately consolidated partnership**

	For the nine months ended		For the three months ended		For the year ended
	September 30 2006	September 30 2005	September 30 2006	September 30 2005	December 31 2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Working capital, net (excluding cash and cash equivalents)	(2,239)	-	(2,239)	-	-
Other assets	134	-	134	-	-
Investments in corporation, net	8,823	-	8,823	-	-
	<u>6,718</u>	<u>-</u>	<u>6,718</u>	<u>-</u>	<u>-</u>