

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

### **Directors' Report on the Company's State of Affairs As of December 31, 2006**

Pursuant to the Securities Regulations (Periodic and Immediate Financial Statements"), 1970, we take pleasure in submitting to the shareholders, the Directors' Report of Shrem. Fudim, Kelner and Co. Ltd.. ("the Company") for the year ended December 31, 2006 ("the reporting year" or "the reporting period"). The Company and its subsidiaries will be referred to as the Group in this report.

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

The Company is a holding company that operates primarily in the areas of capital markets, industry, communications and technology, real estate and infrastructures, digital printing and commerce and services.

**Capital markets:** - The Company is engaged in a variety of activities in the capital markets through its subsidiary, Leader Capital Markets Ltd., which concentrates the activities of Leader Issuances, Leader & Co., Leader Management and their subsidiaries (hereinafter – together – the "Leader Capital Markets Group"). 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. ("Sphera Management"), which manages a number of hedge funds including the Sphera Fund, a hedge fund for investment in marketable securities. In addition, in December 2006, the Company and a British investment bank named Shore Capital Finance Limited founded an investment fund for foreign investors that will invest in securities traded in Israel and abroad.

In March 2007, the Sphera Global HealthCare Fund was set up together with Moshe (Mory) Arkin (50%) and Sphera Management (50%). The fund will invest mainly in financial assets having a connection with the healthcare industry. The investors in the fund will be Israeli and foreign residents including Israeli and foreign resident institutional investors. Mr. Mory Arkin invested an amount of \$15 million in the fund. See paragraph 2.1.1 below.

**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"), including the Art PE fund which it manages, and through the investee companies, Telit, Cimatron Ltd., YES, and various companies owned by Polar Communications, and through the Company's direct investments. See also Paragraph 2.3. below.

**Real Estate and Infrastructures** – The Company operates through directly and indirectly held investees – Leader Real Estate, Polar Real Estate, Ophir Holdings, Sitips, and the holdings of the Group in additional real estate properties. See paragraph 2.2 below.

**Digital Printing** - The digital printing sector includes the activities of Nipson Digital Printing Systems PLC and the companies held by it.

**Trade and Services** – The Company operates mainly through investees - Hazera, Reshet and the activity of Dai Telecom.

The Company is engaged, directly and through its investee companies, in purchasing, incorporating, advancing and developing activities and companies in the aforementioned sectors. In addition, the Company is engaged in, among other things, consulting and management services to its investee companies, hedge fund management as described above, consulting in the field of investment banking and in consulting for and management of a number of venture capital funds.

The Company ended the reporting period with net income of NIS 22.4 million, compared with net income of NIS 58.4 million in 2005.

In December 2006, Polar Investments and Leader signed an agreement for investment in Polar Investments by way of an allotment of shares and a grant of an option to the investor. See paragraph 2.7.4 below.

Polar Investments intends on focusing its activity in the fields of real estate, infrastructures, tourism and vacations, both in Israel and abroad. Other activities of Polar Investments in other areas will be sold, subject to the relevant market conditions and the business discretion of Polar Investments.

During the reporting period, Leader purchased from Polar Investments, through an exercise of rights, shares and option warrants of Polar Communications that were offered to the public holders of shares of Polar Investments through a prospectus.

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 holds, directly and indirectly, 45.9% of the issued and paid-in share capital of Polar Communications. See paragraph 2.7.3 below.

Proximate to the date of the issuance of this report, Leader raised an amount of NIS 125 million through a private placement, by expanding Leader's Series D debentures. See also paragraph 2.7.5 below.

In April 2006, the Company and Leader distributed dividends of NIS 15 million each. In addition, Polar Communications, Urdan and Leader Capital Markets distributed dividends of NIS 50 million, NIS 10 million and NIS 26 million, respectively. Subsequent to the balance sheet date, Leader Capital Markets distributed an additional dividend of NIS 13 million.

Subsequent to the balance sheet date, the Company and Leader declared cash dividends of NIS 30 million and NIS 44 million, respectively, while Urdan declared a dividend in an amount of NIS 11 million.

## **2. Exceptional events during the reporting period and until proximate to the date of circulation of this report, presented by segment activity**

### **2.1 The Capital Market**

2.1.1 The Sphera Fund ("Sphera") is a fund that invests in marketable securities and is managed by Sphera Management.

In December 2006, the Puma Fund was set up by a British investment bank, Shore Capital Finance Limited, the Company and some of the shareholders of Sphera Management. This fund is designed for foreign investors and invests in marketable financial assets in Israel and abroad.

Sphera Management undertook to provide the manager of the Puma Fund with consulting services in respect of its assets in accordance with the policy of the board of directors of the Puma Fund. Sphera Management has an agreement to receive consulting fees as a percentage of the volume of the managed assets which will be paid to the management company on a monthly basis. The share of the Company in the success and management fees of the Puma Fund (indirectly) is 30%.

In March 2007, the Sphera Global HealthCare Fund was set up. In addition, Sphera Global Healthcare Management LP (hereinafter - the "fund manager") was also set up by Mory Arkin (50%) and Sphera GPLP (50%) (hereinafter - the "Partnership"). The control over the fund manager is jointly held by the Company (indirectly through the Partnership) and Mory Arkin. The share of the Company in the success and management fees in the HealthCare Fund (indirectly) is 21.25%.

The fund will invest mainly in foreign financial assets having a connection to the healthcare industry. The investors in the fund will be Israeli residents and foreign residents, including Israeli and foreign-resident institutional investors. Among the investors in the fund will be Mory Arkin who, in the initial phase, invested an amount of \$15 million. In addition, the boards of directors of Technologies and Polar Communications decided to invest an amount of \$2 million each (which investments were ratified by their General Shareholders meetings). In addition, Leader invested in the Healthcare Fund an amount of \$1 million out of a total of \$8 million that is earmarked for investment in funds managed by Sphera Management and that was approved by the General Shareholders meeting of Leader.

As of the date of the release of the financial statements, the total volume of the managed funds is \$185 million.

- 2.1.2 At the end of 2005, the board of directors of Leader decided to concentrate the Group's capital market activity under the banner of a new company that was incorporated on January 3, 2006, Leader Capital Markets Ltd. (Leader Capital Markets). The subsidiary of Leader was set up to hold all of the companies which are engaged in capital market activity, Leader & Co. Investment House Ltd. and Leader Issuances (1993) Ltd.

In February 2006, Leader Capital Markets issued a prospectus, whereby it made an initial public offering of its securities to the public (the "Prospectus"). According to the Prospectus, Leader Capital Markets offered to the public 2,170,000 ordinary shares, par value NIS 0.01 each. The consummation of the issuance under the Prospectus took place on March 7, 2006 and the proceeds in respect of the issuance amounted to NIS 33 million (prior to deduction of issuance costs).

As a result of the issuance, the share of Leader in Leader Capital Markets decreased to 66%, and it recorded a NIS 20 million gain on the decrease in holding, in its financial statements of the first quarter of 2006.

On December 31, 2006, Leader Capital Markets purchased 264,920 ordinary shares of Leader Capital Markets from its former employees due to their

termination of employment. In addition, the vesting period of the shares of Leader Capital Markets that were allotted to employees and senior officers of Leader Capital Markets ended.

As a result of the above, the percentage of Leader in Leader Capital Markets declined to 65% and it recorded in the financial statements of the fourth quarter of 2006 a gain on a decrease in the percentage held in an amount of NIS 2.2 million (the share of the Company – NIS 1.3 million).

- 2.1.3 During the reporting period, a subsidiary of Leader Capital Markets paid an amount of NIS 9.2 million to Yellin-Lapidot and to Yair Lapidot, in consideration for the transfer and allotment of shares of Yellin-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 Yellin-Lapidot.

On October 5, 2006, the subsidiary of Leader Capital Markets exercised the aforementioned option for an amount of NIS 6.7 million. Subsequent to exercising the option, the subsidiary of Leader Capital Markets holds 50% of the capital of Yellin-Lapidot. The excess cost generated in the books of Leader Capital Markets on the purchases described above, in an amount of NIS 13.1 million, is presented in the balance sheet of Leader Capital Markets as part of "Other assets" and is allocated to intangible assets, as follows: an amount of NIS 3 million was allocated to Provident Fund Management and is amortized over the economic life of 15 years, and the balance was allocated to goodwill.

The volume of portfolios, mutual funds, and provident funds managed by Yellin – Lapidot as of the balance sheet date exceeds NIS 4.5 billion.

- 2.1.4 Subsequent to the balance sheet date, Leader Issuances entered into an underwriting agreement whereby it guaranteed the purchase of the shares of Oil Refineries Ltd. ("ORL"), in an amount of NIS 340 million, comprising 11.2% of the volume of the sales offer to the public of the shares of ORL made by the State of Israel, under a sales offer prospectus issued on February 13, 2007. On the basis of the results of the sales offer, Leader Issuances was not required to realize its underwriting commitment, as above. The total commissions received by Leader Issuances on the aforementioned sales offer amounted to NIS 15 million.
- 2.1.5 Total revenues from the capital market segment during the reporting period amounted to NIS 135 million and total segmental income before tax and before unallocated expenses amounted to NIS 90 million in 2006 (revenues of NIS 121 million and income of NIS 90 million last year).

## **2.2 Real estate and infrastructures**

- 2.2.1 During the reporting period, Leader, through a wholly-owned subsidiary (Leader Real Estate) signed, together with a third party (hereinafter - the "Partner"), a framework agreement for the purchase of projects involving commercial assets that are leased in Germany, at a total amount of €110 million. The indirect share of Leader Real Estate in the transaction was 47.5%. The total investment of Leader Real Estate is 4.7% of the transaction and amounted to €4.5 million.

In addition, an agreement was signed with a foreign banking institution which provided financing for the transaction at a rate of 90% of the purchase cost. Additional supplementary financing of 3% of the volume of the

transaction was made available to the transaction by a partnership jointly managed by two companies, one of which is controlled by the Company (the “Partnership”).

During the reporting period, the parties completed the purchase of 28 commercial assets including a shopping mall and supermarkets at a purchase cost (including various purchase-related expenses) of €110 million which constituted the total and final volume of the transaction.

In December 2006, Leader Real Estate and the aforementioned Partners signed an agreement for the cash sale of the shares they held in a foreign company through which the aforementioned investment in projects was carried out, for an amount of €33 million. The share of Leader Real Estate in the proceeds amounted to €13 million.

As a result of the consummation of the transaction, Leader Real Estate recorded a pre-tax gain of NIS 46 million in its 2006 financial statements (the share of the Company – NIS 26 million).

- 2.2.2 In the reporting period, Leader, through 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 up to €30 million. The indirect share of Leader Real Estate in the venture is 32.5%.

Additionally, an agreement was signed with a foreign financial institution, which provides financing to the venture at the rate of 90% of the purchase cost.

The share of Leader Real Estate in the financing of the aforementioned assets, net, amounted to €3.2 million as of the date of the release of the financial statements.

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 €30 million. In the first stage, immediately following 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.

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

- 2.2.3 In October 2006, an investee company of Leader Real Estate refinanced the post office building through a foreign bank which had granted a “balloon” loan to finance the purchase of the post office in an amount of €17.4 million (hereinafter - the “Loan”), for a three-year period, at variable interest at the Euribor rate for three months, and a margin of 1.5% per annum.

The proceeds of the loan were used to repay shareholders loans, including repayment of the shareholder loan furnished by Leader Real Estate in an amount of €4.8 million (which was partially financed by a loan from a financial institution and partially by self means) and repayment of a mezzanine loan and the accrued interest thereon, received from a limited partnership, the limited partners of which are third parties, and the general

partner of which is a company controlled by the Company (the “Canaf Partnership”).

- 2.2.4 On August 19, 2006, a foreign company controlled by Leader Real Estate (the "Subsidiary") signed an agreement with an unaffiliated third party (the “Third Party”) for the purchase of half of the shares of five 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 (550 units) and some is designated for commercial and hotel use. They are all located on the Istrian Peninsula in Croatia.

The Subsidiary paid an amount of €10.1 million in consideration of the shares, of which €2 million was financed by the Canaf Partnership. The balance was financed by the Subsidiary’s current resources.

The Subsidiary is taking steps to receive financing from foreign banks 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 an amount of €0.6 million as interim financing until the bank financing is received, and it is expected to provide another €0.7 million.

In February 2007, Leader Real Estate, through the Subsidiary, entered into another agreement with the Third Party (who is a partner in the previous transaction in Croatia) for the purchase of 50% of an additional Croatian company (hereinafter - the “Croatian Company”) which is a wholly-owned subsidiary of the Third Party, and the assignment of 50% of the shareholders’ loans in the Croatian Company to another Dutch company. The Croatian Company is the registered owner of property in Croatia, on the Istrian Peninsula, covering an area of 2,200 square meters, designated for residential construction. In addition, the Croatian Company signed an agreement with a third party for the purchase of additional property covering an area of 7,240 square meters, also located on the Istrian Peninsula, and also designated for residential construction. The consideration for the additional property has not yet been paid by the Croatian Company.

In February 2007, the subsidiary paid an amount of €1.46 million to the aforementioned third party in respect of the purchase of the Croatian Company and the assignment to the subsidiary of 50% of the shareholders’ loans in the Croatian Company.

As part of the agreement, the parties undertook to obtain the necessary financing for the completion of the purchase of the second property by the Croatian Company. In addition, the parties undertook to finance, in equal shares, the purchase of two additional pieces of property through the Croatian Company.

- 2.2.5 In December 2006, Leader Real Estate entered into an agreement with a promoter (which is unrelated to Leader Real Estate, hereinafter - the “Promoter”) for the investment in a foreign company wholly-owned by the Promoter, S.L. Real Estate Limited (hereinafter – “S.L.” or the “Foreign Company”) in an amount of €10 million (90% of which will be

shareholders' loans), in return for 80% of the issued and paid-in share capital of the Foreign Company.

The Foreign Company is engaged primarily in promoting residential real estate projects and concentrates its activities in Central and Eastern Europe.

In addition, the Leader signed an agreement with another wholly-owned company of the Promoter to render management services to the Foreign Company.

On December 31, 2006, the Foreign Company completed fundraising in an amount of €6.25 million. Part of the fundraising was carried out through the Canaf Partnership. Half of the funds raised were invested in the equity of the Foreign Company, while the other half will be placed at the disposal of the Company as a loan at the same terms as the shareholder loans of Leader Real Estate. As a result of the aforementioned fundraising, Leader holds 59% of the equity of the Foreign Company. As a result of the fundraising and in respect thereof, Leader Real Estate recorded a gain on decline in percentage held in an amount of NIS 8.5 million in the fourth quarter of 2006. The share of the Company was NIS 4.9 million.

As of the date of the release of the financial statements, S.L. has entered into preliminary contracts in connection with some projects. Consummation of some of these transactions is contingent upon a number of pre-conditions, including the conducting of a due diligence.

#### **(1) Bulgaria – Bansko Project**

A portfolio that includes six projects spread out over six parcels of land in the city of Bansko, located 140 kilometers south of the capital, Sofia. A total of 900 dwelling units are planned for these projects.

One of the parcels described above is located near the city of Razlog (considered to be the central city of this district) and near a golf course currently undergoing construction.

Bansko is a popular ski resort in Central Europe in general and in Bulgaria in particular, attracting many investors in recent years from European countries.

The expected volume of the investment is €43 million (50% of which is S.L.'s share – through a jointly held Cypriot subsidiary).

For information pertaining to the financing agreement with partnerships managed by the Canaf Partnership, see Note 10C(2)e of the financial statements.

As of the date of the preparation of the financial statements, S.L. signed an agreement for the purchase of shares and a shareholders agreement. Completion of the transaction is expected to take place in the beginning of the second quarter of 2007.

#### **(2) Romania – Bucharest – Pipera project**

S.L. purchased (through a jointly owned (50%) Romanian subsidiary) property in the Pipera neighborhood, covering an area of 42 thousand square meters, for a total amount of €12 million. An amount of €6 million of the purchase cost was financed through loans obtained from a local bank. The

project is expected to contain 1,200 dwelling units, at a total investment of €106 million.

For information pertaining to the financing agreement with partnerships managed by the Canaf Partnership, see Note 10C(2) of the financial statements.

As of the date of the preparation of the financial statements, the transaction was completed.

**(3) Romania – Sinaia project**

S.L. is scheduled to purchase (through a jointly owned (50%) Romanian subsidiary) property in the city of Sinaia, located 120 kilometers north of Bucharest, covering an area of 27 thousand square meters, for a total amount of €3.4 million. The project is expected to contain 440 dwelling units, at a total investment of €23 million.

As of the date of the preparation of the financial statements, S.L. signed a preliminary agreement, subject to a due diligence to the satisfaction of S.L. Completion of the project is expected to take place in the third quarter of 2007.

**(4) Romania – Bucharest – Voluntar project**

S.L. is scheduled to purchase (through a jointly owned (50%) Romanian subsidiary) 100% of the shares of a Romanian company which owns property in the Voluntar district (northeast Bucharest), covering an area of 40 thousand square meters, for a total amount of €12 million. The project is expected to contain 1,100 dwelling units, at a total investment of €90 million.

As of the date of the preparation of the financial statements, S.L. signed an agreement for the purchase of shares of a Romanian company that owns the rights in the property. The transaction is subject to due diligence work which is currently being carried out, as well as to the furnishing of a construction permit by the sellers. Completion of the project is expected to take place in the beginning of the second quarter of 2007.

**(5) Russia – a project near Moscow**

S.L. is scheduled to purchase (through a jointly owned (50%) Russian subsidiary) 100% of the shares of a Russian company which owns the rights to construct a residential project in an area located north of Moscow (approximately 70 kilometers from central Moscow). The transaction has a cash component (US\$ 3 million) as well as a percentage of the sales that will be paid to the seller out of the proceeds of the project (18% of the proceeds of the combination transaction). The project is expected to contain 7,000 dwelling units, at a total investment of €250 million.

As of the date of the preparation of the financial statements, S.L. signed a preliminary agreement subject to a due diligence to the satisfaction of S.L. Completion of the project is expected to take place during the second quarter of 2007.

**(6) S.L. is scheduled to purchase 100% of the shares of a Baltic company which owns property covering an area of 8,500 square meters, for a total of €6.5 million.**

The project is expected to contain 330 dwelling units, at an investment of €35 million.

As of the date of the preparation of the financial statements, S.L. signed a preliminary agreement subject to a due diligence to the satisfaction of S.L. Completion of the project is expected to take place during the second quarter of 2007.

- 2.2.6 In September 2006, a partnership held by Polar International (25.5%) signed an agreement for the sale of the “Gerard” building in Manhattan (New York) (hereinafter – in this section – the “Building”) for an amount of US\$ 82 million.

According to the sales agreement, at the closing date of the sale of the Building, which took place on January 19, 2007, the partnership deposited an amount of US\$ 3.5 million in a trust account for a period of 14 months following the closing date, to secure the quality of the renovation being carried out in the Building in accordance with the format agreed-upon with the purchasers. The money held in escrow will be released upon fulfillment of a number of conditions as set out in the agreement.

As a result of the completion of the sale of the Building, Polar Investments will record a pre-tax gain (net of the minority share) of NIS 16 million in the financial statements of the first quarter of 2007.

- 2.2.7 During the reporting year, Polar Real Estate recorded a loss on the write-off of its investments in two projects – see Note 10C2(b)2 of the financial statements.
- 2.2.8 For information on transactions of Polar International Real Estate – see Note 10C2(b)2 of the financial statements.
- 2.2.9 The major significance of the operations described above, together with other activity in the field of real estate and infrastructures, involves the recording of significant expenses in the short-term (mainly financing expenses on loans taken to purchase some of the aforementioned projects) in favor of the construction and improvement of the projects and the sale thereof in the long-term at a significant profit.
- 2.2.10 Total income of the real estate and infrastructure segment before tax and before unallocated expenses amounted to NIS 54 million in 2006, compared with NIS 19 million in 2005.

## **2.3 Communications and technology**

### **2.3.1 Technology**

- A. After years of losses and breaking even, Technologies concluded the year with income of NIS 8.4 million.
- 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 and a wholly-owned subsidiary sold 3,942,670 par value ordinary shares of Technologies for a total consideration of NIS 10.2 million.

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 is engaged in a new field of activity – Private Equity. This activity includes 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 period 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 6.9 million (the Company's share is NIS 5 million). Superior is a public company, the shares of which are traded on the Tel Aviv Stock Exchange.

On February 27, 2007, Superior published a prospectus to issue convertible debentures and option warrants in an amount of NIS 100 million, as well as a rights offer to its shareholders. Art P.A. exercised all of the rights it was offered under the prospectus in return for an amount of NIS 9.5 million. See also Note 10D2q to the financial statements.

E. During the third 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. See also Note 10D1h to the financial statements.

G. In March 2006, Technologies issued securities pursuant to a prospectus for a public offering as detailed in Note 10D1i 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. 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 part 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 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 trade on an American stock exchange and raising capital as a shell firm, so that it can merge into 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 as part of a private placement that will take place at the same time as an IPO.

- J. During the third quarter of 2006, the Platinum Fund recorded a gain of \$1.35 million (NIS 5.8 million) in respect of its share in the distribution of funds carried out by Shellcase Ltd. (hereinafter – “Shellcase”) in which the Platinum Fund has a 9% share. Shellcase is engaged in the development of technology that provides miniature storage solutions. At the end of 2005, Shellcase sold all of its intellectual property to Tessera Technologies Inc. for an amount of \$33 million. The share of Technologies in the abovementioned gain was an amount of NIS 1.6 million (the share of the Company – NIS 1.1 million).

During and subsequent to the reporting period, out of a total amount distributed by the Platinum Fund to its investors, Technologies received an amount of \$1 million as a return of its investment.

To the best of Technologies’ knowledge, based on various publicized items, Voltaire, which is a private company and which is engaged in the development of linkage products for broad-band communications, made an in-principle decision to start preparations in advance of a possible IPO on the NASDAQ and is has started the initial process together with consultants and investment houses. The timing and scope of the issuance and the value of Voltaire prior to the issuance have not yet been finalized. Since the issuance, by its nature, is subject to the influence of a variety of factors, there is no certainty as to when and if it will come to fruition.

- 2.3.2** In March 2006, 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).

In December 2006, Mediound signed a non-binding memorandum agreement arranging for the investment of a strategic investor in Mediound, on the basis of which the parties will act to finalize the negotiations between them. According to the memorandum agreement, it was agreed that in the first phase, the strategic investor will purchase from the shareholders of Mediound US\$10 million in shares at a per share price that reflects a company value of US\$ 100 million. Subject to additional conditions set out in the memorandum agreement, there is an option for a further investment of additional amounts by the strategic investor (up to a holding of 51% in the share capital of Mediound) at a per share price that reflects a company value of US\$ 200 – 300 million.

- 2.3.3** In November 2006, Polar Communications sold all its shares in Pointer, which were presented in part as short-term investments and in part as permanent investments, for a total consideration of NIS 16 million. As a result of the sale, Polar Communications recorded a pre-tax gain of NIS 5.4 million in the fourth quarter of 2006.

- 2.3.4** In the fourth quarter of 2006, Storage announced the sale of all of its shares to a foreign company for an amount of US\$ 50 million. Polar Communications held Storage through Koonras and its share in the consideration of the sale of Storage was NIS 16 million. In addition, the share of Ophir Tech Ltd. (an affiliated company in which Polar Communications has a 42% share) in the consideration was NIS 15

million. The total proceeds actually received as of the date of this report were NIS 27 million. The balance of the sales proceeds is expected to be received within 18 months of the sale date. As a result of the sale described above, Polar Communications recorded a pre-tax gain (including its share in the gain recorded by Ophir Tech) of NIS 3.5 million in the fourth quarter of 2006.

- 2.3.5** In March 2007, Polar Investments sold its investment in Aqwise (29.9%) to Elron Electronics Industries Ltd. for an amount of NIS 12 million.

As a result of the sale, Polar Investments will record a pre-tax capital gain in that amount in the financial statements of the first quarter of 2007.

- 2.3.6** In March 2007, a subsidiary of Telit, “Telit Srl Wireless Solutions” (“Telit Srl”) signed an agreement with a third party (the “Investor”) whereby the Investor will invest an amount of €16 million against an allotment of 10% of the shares of Telit Srl. In the first phase, an amount of €9 million will be invested, and an amount of €7 million will be invested in December 2008, subject to Telit Srl’s compliance with certain milestones, as set out in the agreement. Concurrently, Telit Srl signed a strategic production agreement with a subsidiary of the Investor (the “Production Company”) for the production of modules of the Telit Group in Europe. Pursuant to that agreement, Telit Srl received the rights to 19.9% of the share capital of the Production Company, for an amount of €1. At the request of Polar Investments, Telit announced that, upon completion of the transaction described above, Telit would record a gain of €7.6 million on the decline in the percentage held.

In addition, Polar Investments commenced negotiations for the sale of half of its holdings in Telit to a group of foreign investors (including part of Telit management) for an amount of £ 0.43 per share.

- 2.3.7** D-Pharm, a company in which Polar Communications has a 5.2% share, is engaged in the development of drugs to treat, among other things, disorders in the nervous system, immune systems and cancer. See Note 10C2a to the financial statements.

- 2.3.8** For information regarding additional investments of Polar Communications in Curatech, Mediwound and NST, see Note 10C2a to the financial statements.

- 2.3.9** On December 31, 2006, Leader entered into an agreement with a company controlled by Mr. Aric Kotler (hereinafter - the “Purchaser”) whereby Leader sold the purchaser and institutional investors 23,999,974 shares of Erco which constituted Leader’s entire holdings in Erco at that date, for an amount of NIS 0.95 per share and a total amount of NIS 22.8 million (hereinafter – the “Consideration”). Half of the Consideration was paid in cash upon the sale, while the second half will be paid to Leader by September 30, 2007. The unpaid balance bears interest at an annual rate of 6% (hereinafter – the “Unpaid Balance”). Payment by the buyer of the Unpaid Balance is secured by, among other things, a lien in favor of Leader on the shares of Erco owned by the buyer.

For more information on the covenants in connection with the conclusion of the management agreement between the companies, see Note 10C2d to the financial statements.

As a result and in respect of the sale of the shares as described above, Leader recorded a pre-tax gain of NIS 8.5 million in the financial statements of the fourth quarter of 2006 (the share of the Company – NIS 4.9 million).

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.

- 2.3.10** The total income of the communications and technology segment, before taxes and unallocated expenses, amounted to NIS 10 million in 2006, compared with income of NIS 170 million in 2005.

## **2.4 Trade and services**

- 2.4.1** In January 2006, Polar Communications, through a wholly-owned subsidiary, signed an agreement (the "Agreement") with a third party for the sale of 6% of the share capital and voting rights in Reshet, for an amount of \$ 2 million. The third party is also purchasing an additional 14% of the shares of Reshet from one of the other shareholders in Reshet.

In June 2006, the transaction was completed and, as a result, Polar Communications holds, indirectly, 30% of the share capital and voting rights in Reshet. As a result of the sale, Polar Investments recorded a pre-tax capital gain of NIS 6 million in the second quarter of 2006. (the share of the Company was NIS 1.2 million).

- 2.4.2** 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 5 million in the second quarter (the share of the Company was NIS 1.7 million).

- 2.4.3** In December 2006, in a combination transaction, Polar Investments sold to a third party, directly and indirectly, all of its holdings in companies that comprise the vehicular activity in East Europe in which Polar Investments invested, for a total amount of NIS 61.4 million, including the assignment of shareholders loans. As a result of the sale, Polar Investments recorded a pre-tax capital gain of NIS 15 million in its financial statements for the fourth quarter of 2006.

- 2.4.4** The total income of the trade and services segment, before tax and before unallocated expenses, amounted to NIS 26 million in 2006, compared with NIS 62 million in 2005.

## **2.5 Industry**

- 2.5.1** In May 2006, a compromise agreement (the "Compromise Agreement") was signed between the plaintiffs and defendants (one of which is H. Aloni Industries Ltd., a subsidiary of Urdan) in connection with a suit that was filed in the past in respect of restrictive arrangements, described in Note 10C(2)c of the financial statements.

As a result of this compromise, which was filed for the approval of the district court (which has not yet been forthcoming), a provision in an amount of NIS 0.7 million was included in the financial statements of

Aloni for the first quarter of 2006 in respect of its share in the Compromise Agreement. The provision was carried to the income statement of Urdan for the reporting period and presented under "Other expenses". For additional information on the Compromise Agreement, see Note 10C(2)c of the financial statements.

**2.5.2** As of the date of this report, EER was held by Urdan, the Company and Technologies at rates of 17.2%, 7.4%, and 3%, respectively (21%, 9%, and 3.6% fully diluted, respectively). In March 2007, the demonstration facility set up by EER in Israel for implementation of its innovative plasma technology for the treatment and removal of solid waste was successfully and continuously operated for the first time.

In March 2007, EER announced that it intends on assessing the possibility of issuing its shares on the stock exchange (in Israel and/or abroad), at an EER company value of hundreds of millions of dollars, toward the end of 2008. This is a forward-looking ambition, based on assessments which, by their very nature, may change and/or not come to fruition in connection with, among other things, the realization of the commercial potential of the technology of EER for the treatment of waste abroad and the volatility of the capital markets in Israel and abroad.

In July 2006, an agreement was signed between EER and the shareholders who participated in a round of fundraising in 2005 which raised an amount of US\$ 3.1 million (through shareholders loans together with options to purchase EER shares), whereby the aforementioned shareholders loans were converted into shares of EER at an EER company value of US\$ 65 million (before the conversion) and concurrently, the options were cancelled. Urdan, the Company, and Technologies were among the shareholders who took part in that round of fundraising, in amounts of US\$ 0.5 million, US\$ 0.4 million and US\$0.15 million, respectively.

Further to EER's requests in May 2006 to Urdan, the Company, and Technologies (hereinafter - the "guarantors"), the guarantors undertook to grant guarantees of US\$ 2.5 million (hereinafter - the "guarantees") with banking institutions in favor of EER to secure receipt of short-term bank credit by EER. Of the total amount of the guarantees, \$1.6 million was provided by Urdan, \$0.7 million by the Company, and \$0.3 million by Technologies. The breakdown of the amounts of the guarantees was determined on the basis of the relative shares of the guarantors in the issued share capital of EER.

The guarantees are several, and not joint and several, such that the banking institution can demand payment from each of the guarantors only up to the amount in respect of which each guarantor gave the guarantee. In addition, the guarantors are entitled to guarantee commissions at an annual rate of 2% of the amount of the guarantee.

The guarantees grant each of the guarantors (separately) the right to invest in the share capital of EER the amount of the guarantee that it gave, in whole or in part, at a price of US\$5,402.4 per share (reflecting as of the date of the preparation of this publication an EER company value of US\$ 71.2 million).

In addition, Urdan, the Company and Technologies undertook to furnish additional guarantees of up to \$3 million, broken down as follows: Urdan - \$1.9 million, the Company - \$0.8 million and Technologies - \$0.3 million.

The right of conversion was granted to the guarantors even in the event that EER does not utilize these credit lines.

At the end of 2006 and the beginning of 2007, EER raised an amount of US\$ 4 million from two private investors, at a price of US\$5,402.4 per share, of which an amount of US\$ 1.5 million has not yet been received and is contingent upon a milestone that was stipulated between the parties and which was fulfilled as of the date of this report. Upon completion of the entire investment, the two investors will hold 5.6% of the capital shares of EER, with the investment reflecting an EER company value of US\$ 73 million (after this investment).

In the past certain of the shareholders of EER (including Urdan, SFK and SFKT) granted shareholders loans to EER in accordance with the founders agreement and its amendment. As of the date of the preparation of the financial statements, these loans amounted to US\$ 17.3 million (including accrued interest). Of this amount, the shareholders loans granted by Urdan, the Company and Technologies amounted to US\$ 7.2 million, US\$ 3.1 million, and US\$ 1.2 million, respectively. In February 2007, EER decided to allow these shareholders to convert these loans into shares of EER at an EER company value of US\$ 135 million before the conversion. As of the date of this report, the Company has not yet decided to accede to this request.

In the event that Urdan, the Company and Technologies decide to exercise their right to investment and convert the aforementioned shareholders loans in their entirety into shares of EER, as well as the guarantees given by them, as above, then Urdan, the Company and Technologies will hold 21%, 9%, and 3.6% respectively, of the share capital of EER.

For additional information, see also Note 10N to the financial statements.

- 2.5.3** Further to the continued losses of the subsidiary, Batei Yezika Vulcan Ltd. (“Vulcan”), in recent years due to, among other things, the continued strengthening of competition, mainly from imports, it was decided in December 2006 to cease the operations of Vulcan. It is expected that cessation of operations will be completed during the course of the second quarter of 2007 upon the completion of production and the supply of the backlog of orders received from its customers.

Vulcan, which is a wholly-controlled subsidiary of Urdan, was engaged mainly in the forging of metal for the civilian market, as part of Urdan’s metal segment.

Please note that the major activity of Urdan’s metal segment which is carried out at the company’s plant in Netanya, mainly in the forging of metals for the military market, is unaffected by this decision.

In view of the above, the financial statements of Urdan for the fourth quarter of 2006 included a loss in an amount of NIS 8 million, mainly as a result of the decline in value of certain assets on the books of Vulcan (mainly inventory, machinery and equipment) and the adjustment of certain liabilities (mainly in respect of the termination of employees).

- 2.5.4** The total income of the industry segment, before tax and before unallocated expenses amounted to NIS 46 million in 2006, compared with NIS 75 million in 2005.

## 2.6 Digital Printing

- 2.6.1 During 2006, the Polar Investments Group transferred loans in an amount of €4 million to Nipson. The balance of the loans transferred by the Polar Investments Group to Nipson as of December 31, 2006 amounted to €6 million.

These amounts were transferred under an agreement between Polar Communications and a wholly-owned subsidiary of Nipson (the "Subsidiary") dated February 13, 2006, whereby Polar Communications is entitled to transfer to the Subsidiary from time to time amounts to finance the working capital of the Subsidiary.

The Subsidiary undertook to repay the amounts of the loans at the payment dates of invoices the Subsidiary received from certain of its customers or to replace these invoices with other invoices at a ratio of 120% of the loans.

In accordance with an amendment dated March 2007, the date for the repayment of these loans was set for May 1, 2008, notwithstanding the fact that Polar Communications has the right to demand repayment of the loans at earlier dates whenever there is an impairment in the results of operations of the Subsidiary or in similar instances as defined in the agreement. In addition, the board of directors of Polar Communications decided in February 2007 to increase the loans to Nipson by an amount of up to €2 million, of which an amount of €1.5 million has been transferred as of the date of this report as a short-term loan, in accordance with the loan agreements signed between Polar Communications and the Subsidiary when the loans were granted.

The balance of the investment of Polar Communications in the shares of Nipson (excluding the aforementioned loans) on the books of Polar Communications as of December 31, 2006 amounted to NIS 35.8 million. The market value in London of the investment proximate to the date of this report was NIS 43.8 million.

For additional information regarding Nipson, see Note 10C(2)a of the financial statements.

- 2.6.2 The total loss of the digital printing segment, before tax and before unallocated expenses, amounted to NIS 12 million in 2006, compared with income of NIS 16 million in 2005.

## 2.7 Other events

- 2.7.1 Mr. Yitzchak Shrem, Chairman of the Board, renders management services to the Company through a company under his control (the "Shrem Company"). Under the agreement with the Shrem Company, it is entitled to receive an annual bonus on the basis of the pre-tax adjusted income (consolidated), plus the share of the Company in the results of affiliated companies (the "Representative Income"). The Shrem Company gave notice as follows:

- A. Commencing in 2006 and thereafter, it agrees that the rate of the annual bonus will be reduced to 5% (instead of 7.5%) of the Representative Income.
- B. In addition, the annual bonus will be subject to a high-water mark, with the calculation of the income for purposes of the annual bonus

being based on an aggregate basis. In the event that in any given year, commencing in 2006 and thereafter, the Company ends the year with a loss, the amount of the loss will be deducted from the Representative Income to be earned by the Company in the years following the year in which it incurred the loss. See also Note 32B of the financial statements.

2.7.2 Mr. Yair Fudim, Director and CEO of the Company, provides the Company with management services through a company under his control ("Fudim Co."). According to the agreement with Fudim Co., it is entitled to receive an annual bonus, computed on the basis of the pre-tax adjusted income (consolidated), plus the share of the Company in the results of affiliated companies (the "Representative Income"). Fudim Co. notified the Company that:

- A. Commencing in 2006 and thereafter, it agrees that the rate of the annual bonus will be reduced to 2% (instead of 2.5%) of the Representative Income.
- B. The annual bonus will be subject to a "high-water mark", with the calculation of the income for purposes of the annual bonus being based on an aggregate basis. In the event that in any given year, commencing in 2006 and thereafter, the Company ends the year with a loss, the amount of the loss will be deducted from the Representative Income to be earned by the Company in the years following the year in which it incurred the loss.

In addition, Mr. Yair Fudim, Chairman of the Board, Director and CEO of Leader, provides Leader with management services through Fudim Co. According to the agreement with Fudim Co., it is entitled to receive an annual bonus, computed on the basis of the pre-tax adjusted income (consolidated), plus the share of Leader in the results of affiliated companies (the "Representative Income").

Fudim Co. notified Leader that, commencing in 2006 and thereafter, the annual bonus will be subject to a "high-water mark", with the calculation of the income for purposes of the annual bonus being based on an aggregate basis. In the event that in any given year, commencing in 2006 and thereafter, Leader ends the year with a loss, the amount of the loss will be deducted from the Representative Income to be earned by Leader in the years following the year in which it incurred the loss. See also Note 32C of 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 course of action involving the sale of the shares of Polar Communications held by Polar Investments, to its shareholders, is justified from an economic standpoint and fair from the standpoint of the shareholders.

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

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

On June 29, 2006, Leader purchased the securities offered from Polar Investments, by way of rights through a sales offer, 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 investment in the 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 its participation in the aforementioned offer, at an amount of up to 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 the reporting period amounted to NIS 83 million. Following the completion 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, directly and indirectly, 45.9% of the issued and paid-in share capital of Polar Communications. The book value of Polar Communications on the books of Leader totaled NIS 115 million as of the balance sheet date. Leader has obtained bank financing for most of this acquisition.

- 2.7.4** In December 2006, after obtaining the approval of the Audit Committee of Polar Investments, the board of directors of Polar Investments authorized that company to enter into an investment agreement by way of an allotment of shares (the "Allotment Agreement") with HFZ Holding LLC, a company owned by a businessman, Zil Feldman (hereinafter – "Zil"). On February 13, 2007, HFZ Holding LLC notified Polar Investments that it was assigning its rights and commitments under the agreement to F.D. Holdings Ltd. (the "Investor"), a company owned by Zil (50%) and Rolit Project Marketing Ltd., a company wholly owned by Mr. Dov Weiss (50%), the CEO of Polar Real Estate.

Pursuant to the Allotment Agreement dated December 6, 2006, the Investor will invest an amount of NIS 207 million in Polar Investments, in return for an allotment of 3,388,443 ordinary shares of Polar Investments, par value NIS 1 each, granting the Investor immediately after the allotment 41.2% of the voting rights in Polar Investments and 39.9% of the share capital of Polar Investments. In addition, the Investor will be allotted by Polar Investments, for no additional consideration, 688,091 non-negotiable option warrants (the "Polar Options") for the purchase of 688,091 ordinary shares of Polar Investments, par value NIS 1 each. The investment agreement of Polar Investments and the pursuant allotment of securities were ratified by the General Shareholders meeting of Polar Investments on January 1, 2007.

On February 15, 2007, the initial closing of the agreement took place and Polar Investments received an advance of NIS 20.7 million, after it furnished all of the approvals that it undertook to furnish pursuant to the agreement, against the granting of a bank guarantee in favor of the Investor by Polar Investments pursuant to its undertaking in the agreement.

The completion of the agreement is scheduled to take place within six months of the signing of the agreement, such that Polar Investments will allot the shares and the options against receipt of the balance of the consideration.

Concurrent with the signing of the Allotment Agreement with the Investor, Leader signed an option agreement with the Investor whereby it granted him an option to purchase from Leader 807,131 shares of Polar Investments which it owns (the "Leader Option") and 325,538 options (Series 6) exercisable into shares of Polar Investments.

After completion of the allotment transaction and under the assumption that the Polar Option and the Leader Option will be exercised by the Investor, the Investor will hold 54.7% of the voting rights in Polar Investments and 53.2% of the capital of Polar Investments (see also Note 10C2b(1) of the financial statements).

- 2.7.5** Subsequent to the balance sheet date, proximate to the date of the release of the financial statements, a number of offeree institutional investors (the "Offerees") were allotted 125,000,000 par value debentures (Series D) of the Company, through an expansion of the series of debentures (Series D) that were offered to the public under a prospectus in 2005 (see Note 18B3 of the financial statements) (hereinafter - the "Private Placement" and the "New Debentures").

The New Debentures (Series D) were offered to the Offerees by way of a tender on the quantity of debentures and at a fixed price of NIS 100.25 for every NIS 100 par value (the "Allotment Price").

The net proceeds from the allotment to the Offerees amounted to NIS 125,000 thousand. The New Debentures are identical in all aspects to the debentures (Series D) which the Company issued under the prospectus described above.

As of the date of the release of the financial statements, the balance of debentures (Series D) amounted to 215,000,000.

- 2.7.6** 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 shares of Leader. In addition, an interested party in Leader converted NIS 4,650,000 par value of Series B debentures into 608,487 ordinary shares of Leader.

Subsequent to the balance sheet date, investors who are not interested parties in Leader converted 7,850,000 par value Series B debentures into 1,061,540 ordinary shares of Leader. As of the date of the release of the financial statements, there were 1,430,000 par value and 270,000 par value Series B and Series C debentures of Leader, respectively, in circulation.

In the reporting period, an interested party in Leader exercised 500,000 Series I options for 500,000 ordinary shares of Leader, in consideration for NIS 2 million. During the reporting period and until the date of the release of the financial statements, 641,667 options granted in the past to employees and senior officers of Leader and companies it owns were converted into 310,393 ordinary shares of Leader.

During the reporting period, 529,167 non-negotiable options that had been allotted to senior executives and other employees of Leader expired.

After the aforementioned conversions and purchases of shares on the stock market, proximate to the date of release of the financial statements, the Company effectively held 56% of Leader.

**2.7.7** In May 2006, the Company signed an agreement with Silverbaum Holdings Ltd. (“Silverbaum”) whereby the Company sold all of its holdings in Silverbaum to that company for an amount of NIS 1 million, to be paid in cash, and an amount of NIS 4.4 million to be paid out in four equal annual payments (bearing interest and linkage differentials), commencing on May 18, 2007. In addition, Silverbaum transferred to the Company 1 million shares of World Group Holdings Ltd, a company traded on the stock exchange and all of its holdings in two funds that are managed by Technologies. As a result of this sale, the Company recorded a gain of NIS 3.6 million in the third quarter.

**2.7.8** The chairman of the boards of directors of Polar Investments and Urdan, who also serves in various capacities at additional subsidiaries in the Group, was questioned under warning by the police on January 1, 2007. The chairman of the board cooperated with the investigators, answered all of their questions and was released with no restrictions whatsoever, except for the prohibition against making contact with people connected to the investigation.

For information pertaining to the employment agreements of the chairman of the boards of Urdan and Polar Investments, see Note 32G of the financial statements.

**2.7.9** Further to the aforementioned sales offer prospectus and the change in the holdings in Polar Investments, the Audit Committee and the board of directors of Polar Investments, on November 26, 2006, approved an agreement to receive management and consultancy services from the Company (the “Agreement”).

In January 2007, the General Shareholders meeting of Polar Investments ratified the going into effect of the agreement from January 1, 2007 and it will be in effect for a period of up to 4 years. The going into effect of the aforementioned agreement terminated a similar agreement with Polar Investments dated in 1999. Under the Agreement, Polar Communications will pay the Company an amount of NIS 1,000 thousand a year in return for management and consultancy services, linked to the Index, payable in four quarterly payments.

**2.7.10** Proximate to the date of release of 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.

**2.7.11** For information pertaining to additional events, see also Part A – Description of the Business of the Company enclosed in the Company’s periodic report for 2006.

### **3. Financial condition**

**The following table presents data from the consolidated balance sheet and from the balance sheet of the Company and the private companies under its control (\*) in reported NIS millions of December 2005:**

	As of December 31, 2006			As of December 31, 2005
	Consolidated balance sheet	Company balance sheet	Balance sheet of Company and controlled private companies (*)	Balance sheet of Company and controlled private companies (*)
Current assets	2,272.3	99.9	111.4	145.7
Investments in companies and loans to affiliated and other companies	724.0	361.5	328.2	296.7
Real estate	482.1	-	-	-
Fixed assets	602.0	22.4	24.2	25.2
Other assets and deferred charges	170.0	-	1.6	4.1
<b>Total assets</b>	<b><u>4,250.4</u></b>	<b><u>483.8</u></b>	<b><u>465.4</u></b>	<b><u>471.7</u></b>
Current liabilities	1,545.4	59.4	62.6	85.3
Long-term liabilities	1,673.1	154.0	126.5	102.1
Minority interest	742.2	-	5.9	6.0
Debentures convertible in shares of the Company	-	-	-	11.7
Receipts in respect of options issued by subsidiaries	19.3	-	-	-
Shareholders’ equity	<u>270.4</u>	<u>270.4</u>	<u>270.4</u>	<u>266.6</u>
<b>Total liabilities and shareholders’ equity</b>	<b><u>4,250.4</u></b>	<b><u>483.8</u></b>	<b><u>465.4</u></b>	<b><u>471.7</u></b>

(\*) In this report, the meaning of “the Company and the private companies under its control” is the consolidated balance sheet in which public companies owned directly by the Company are presented on the equity method (Leader and Technologies).

- The Company's shareholders' equity as of December 31, 2006 amounted to NIS 270.4, compared with NIS 266.6 million at December 31, 2005 and represented approximately 58% of total assets of the Company and the private companies under its control.
- The changes in shareholders' equity in the reporting period derive mainly from the Company's earnings of NIS 22.4 million, less the NIS 14.4 million dividend paid by the Company during the reporting period and the self purchase of the shares of the Company in an amount of NIS 4.0 million
- Current assets amounted to NIS 111.4 million as of December 31, 2006 as compared to NIS 145.7 million at the end of 2005. The decrease in current assets is primarily the result of the decrease in cash which was used mainly to invest in investee and other companies and to pay a dividend.
- Investments and loans in investee and other companies amounted to approximately NIS 328.2 million as of the end of December 2006, compared with an amount of NIS 296.7 million at the end of December 2005. The increase is the result of the share of the Company in the earnings of investees during the reporting period in an amount of NIS 31.5 (mainly Leader and Technologies), net of the share of the Company in the dividend of Leader in an amount of NIS 8.6 million and the purchases of the shares of Leader on the stock market and the shares of Technologies purchased from Marubani, as described above.
- The financial liabilities of the Company and the private companies under its control, amounted to NIS 189.1 million as of the reporting date, compared with NIS 199.1 million as of December 31, 2005, reflecting the continuing trend in the improvement of liquidity and the decrease in the liabilities of the Company. The net financial liabilities of the Company as of the end of December 2006, net of its liquid resources amounted to NIS 78 million.

#### **4. Operating results of the Company and the private companies under its control**

##### **General**

The Company ended the year with income of NIS 22.4 million, compared with NIS 58.4 million in 2005 and NIS 48.4 million in 2004.

The income in 2006 derived mainly from the share of the Company in the results of Leader and Technologies and from the share of the Company in the results of Sphera.

The income of the prior year was characterized by income from the capital market segment (and primarily the activity of the Sphera Fund, income from long-term investments on the sale of the balance of the holdings of the Company in DS Securities and the income from investee companies, primarily Leader.

**The following table presents data from the statements of operations of the Company and the private companies under its control in reported NIS millions**

	<b>2006</b>	<b>2005</b>	<b>2004</b>
Revenues from consultation, management, and participation in the earnings of funds	<b>42.0</b>	45.0	39.3
Profit (loss) from long-term investments, net	<b>4.7</b>	7.4	(1.6)
Profit from marketable securities, net	<b>2.6</b>	16.6	14.7
Total costs and other Expenses	<b>(40.9)</b>	(39.6)	(36.0)
<b>Net income before financing</b>	<b>8.4</b>	29.4	16.4
Financing expenses, net	<b>(9.1)</b>	(10.6)	(11.3)
Profit (loss) after financing expenses	<b>(0.7)</b>	18.8	5.1
Company's share in profits of investees, net	<b>31.5</b>	50.2	50.9
Tax expense	<b>(1.0)</b>	(0.8)	(0.5)
Minority interest in profits of subsidiaries	<b>(7.4)</b>	(9.8)	(7.1)
<b>Net income (loss) for the period</b>	<b>22.4</b>	58.5	48.4

(\*) In this report, the meaning of "the Company and the private companies under its control" is the consolidated statement of operations in which public companies held directly by the Company are presented on the equity method (Leader and Technologies).

**The operating results of the Company and the private companies under its control during the reporting period are explained as follows:**

- The Company and the private companies under its control presented turnover from consulting, management and participation in the profits of funds in 2006 in an amount of NIS 42.0 million, compared with NIS 45.0 million in 2005 and NIS 39.3 million in 2004.

These revenues include the share of the Company in the management fees and participation in profits of the Sphera Fund in amounts of NIS 20.8 million, NIS 24.7 million and NIS 19.0 million during 2006, 2005 and 2004, respectively.

In addition, revenues from consulting include revenues from Shrem Fudim Kelner – Financing and Projects Ltd., a company that provides financial consulting services in the field of investment banking, in connection with infrastructure and real estate projects in Israel and abroad, and revenues from SFK-Canaf 2000 Ltd. which provides financial consulting services, consumer club management and marketing projects for its clients.

- During the reporting period, the Company presented profits from marketable securities of NIS 2.6 million as compared with NIS 16.6 million in 2005 and NIS 14.7 million in 2004 (including profits on marketable securities from the Sphera Fund). The decrease in revenues from securities

derives from the weakening of the capital market during the reporting period, mainly in the third quarter of the year, when compared with previous years, and from the effect of the change in the dollar rate on the assets of the Sphera Fund during the reporting period. The Tel Aviv 100 Index rose during the reporting year by 12%, compared with increases of 29% and 19% in 2005 and 2004.

- The Company's share in the earnings of investee companies amounted to NIS 31.5 million in the reporting period, compared with NIS 50.2 million in 2005 and NIS 50.9 million in 2004, and derive from the earnings of the investee companies, Leader and Technologies.
- Total costs and other expenses amounted to NIS 40.9 million in 2006, compared with NIS 39.6 million in 2005 and NIS 36.0 million for 2004. The increase in the costs was due mainly to the increase in the provision for bonuses to executives and employees as a derivative of the performances of the Company and privately held investees and the consolidated results of operations.
- The net financing expenses amounted to approximately NIS 9.1 million in the reporting period compared with NIS 10.6 million in 2005 and NIS 11.3 million in 2004. The decrease in financing expenses during the period derived from the decrease in the "known" CPI during the year which directly impacts on financing expenses deriving from the Company's linked loans.

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

Consolidated revenues from sales, services, consultation, management and underwriting totaled approximately NIS 1,947 million for the reporting year as compared with revenues of NIS 1,904 million in 2005 and NIS 1,814 million in 2004. The major changes in the composition of revenues between the periods are as follows: the increase in revenues of Telit in the communications and technology segment, the increase in revenues in the fields of paint and insulation products in the industrial segment, the increase in revenue turnover in the digital printing segment, and the increase in revenues in the capital market segment. These were offset by the decrease in revenues due to a decrease in the revenues of Polar Real Estate as a result of the completion of the Herzliya apartment project and the cessation of consolidation of Maximedia by Polar Communications commencing in 2006.

The net profit from long-term investments and assets in the reporting period amounted to approximately NIS 126 million, compared with NIS 357 million in 2005 and NIS 159 million in 2004.

The profit for the reporting period derived mainly from the NIS 46 million profit of Leader Real Estate on the sale of a real estate asset as described above, the profit that derived to Polar Communications on the sale of its holdings in Partner, as above, the NIS 22 million profit on the decrease in the percentage holding in Leader Capital Markets as described above, and the gain on the sale of Erco by the Company. These were offset by the impact of the closure of Vulcan operations by Urda and the write-down of real estate projects by Polar Real Estate. The profit in the same periods last year derived mainly from the issuance and sale to a third party of shares of Nipson by Polar Communications, the gain on the issuance of Telit to a third party, the sale of the shares of Partner, the capital gain that derived to Urda on the sale of property in Netanya, the NIS 30 million gain on the sale of the

investment in BSR Europe by the Company, and the sale of the balance of the holdings of the Company in DS Securities.

Net financing expenses totaled NIS 139 in the reporting period, compared with NIS 161 million in 2005 and NIS 141 million in 2004. The decrease in financing expenses derived mainly from the decline in the “known” Index during the reporting period which directly impacts on the financing expenses deriving from the linked loans of the Group companies and from the decline in the volume of credit of Polar Investments and Urdan. These were offset by the decrease in financing income from foreign currency-linked deposits mainly of the Company and Polar Communications and the decrease in financing income from mortgages granted by Polar International, due to the decrease in the exchange rate of the dollar.

The results of business operations of the Company were negatively impacted by the losses of the investee companies, Polar Investments and Polar Communications.

The following table summarizes the operating data from the consolidated financial statements (in reported NIS millions):

	2006	2005	2004
Revenues from sales, services, consultation management and underwriting	1,946.9	1,903.5	1,814.0
Gain from long-term investments, assets, etc., net	126.2	357.2	159.0
Gain from marketable securities, net	42.4	66.8	44.6
Company's share in earnings of investees, net	8.9	-	37.7
<b>Total revenues</b>	<b>2,124.4</b>	<b>2,327.5</b>	<b>2,055.3</b>
Costs of sales and services	1,465.9	1,464.9	1,365.9
Selling and marketing expenses	230.8	202.7	173.8
General and administrative expenses	267.3	269.4	251.6
Share of Company in losses of investees, net	-	21.9	-
Financing expenses, net	139.3	161.0	140.9
<b>Total expenses</b>	<b>2,103.3</b>	<b>2,119.9</b>	<b>1,932.2</b>
<b>Profit (loss) before taxes on income</b>	<b>21.1</b>	<b>207.6</b>	<b>123.1</b>
Taxes on income	(35.3)	(67.9)	(16.5)
<b>Profit (loss) after taxes on income</b>	<b>(14.2)</b>	<b>139.7</b>	<b>106.6</b>
Minority interest in losses (gains) of subsidiaries, net	36.0	(81.8)	(58.2)
<b>Profit before cumulative effect</b>	<b>21.8</b>	<b>58.4</b>	<b>48.4</b>
Cumulative effect as of the beginning of the year of change in accounting principles, net	0.6	-	-
<b>Net profit for the year</b>	<b>22.4</b>	<b>58.4</b>	<b>48.4</b>

See Note 30 to the financial statements for data on operating segments.

For information on the results of operations by quarter, see Chapter D, additional information, attached to this periodic report.

## 6. Liquidity

Cash flows provided by operating activities of the Company and the private companies under its control in the reporting period amounted to NIS 9.5 million. These flows derived mainly from the earnings of the Company and the share of the Company in the earnings of investee companies, the gain on long-term investments and from the net increase in accounts receivable.

Net cash flows used in investing activities in the reporting period totaled NIS 4 million. These cash flows were used mainly for long-term investments in investee and other companies in a net amount of NIS 22 million, offset by the proceeds in respect of marketable securities in an amount of NIS 7 million and the proceeds from the sale of long-term investments in an amount of NIS 11 million.

Cash flows used in financing activities totaled NIS 27.6 million in the reporting period. The cash flows were used mainly in the payment of a dividend of NIS 15 million by the Company to its shareholders, the payment of a dividend of NIS 7 million to the minority shareholders of a subsidiary and the purchase of the shares of the Company in an amount of NIS 4.1 million

## 7. Sources of financing

The current operations of the Company and the private companies under its control are financed mainly by their equity, as well as by bank credit and debentures.

During 2005, the Company changed the mix of its liabilities, from reliance mainly on bank credit to raising capital through debentures issued in public and private offerings. As December 31, 2006, the balance of liabilities to banks and others and debentures, net of liquid resources, amounted to only NIS 78 million.

## 8. Directors with accounting and financial expertise

The Company believes that the experience, education, and qualifications of the members of the board of directors provide them with the proper tools to meet the obligations of the board of directors in connection with the financial statements of the Company. Therefore, the Company determined that the minimum number of directors having accounting and financial expertise to be two directors, taking into consideration, inter alia, the size of the Company, the type and complexity of its operations, the number of members of the board of directors and the composition of the board of directors which includes members having management and professional experience and qualifications.

The members of the board of directors who are, in the estimation of the Company and to the best of its knowledge, directors with accounting and financial expertise, and the information that serves as support for this determination are as follows:

**Itschak Shrem, Chairman of the Board** - academic education in the areas of economics and business administration. He has been serving for many years as Chairman of the Board and Deputy Chairman of the Board of public companies and as a director of many companies, including public companies. Mr. Shrem has experience and knowledge that he has accumulated in all matters that are characteristic of the capital market, to investment banking and to the remaining sectors in which the Company operates, and he is also directly responsible for the approval and issuance of the financial statements.

**Yair Fudim, CEO and Director** - academic education in the areas of economics and business administration. He has been serving for many years as CEO of public companies and as a director of many companies, including public companies. Mr. Fudim has experience and knowledge that he has accumulated in all matters that are characteristic of the capital market, to underwriting and to the remaining sectors in which the Company operates, and he is also directly responsible for the approval and issuance of the financial statements.

**Rubin Zimmerman, Deputy Chairman of the Board** - has broad experience in business management and serves as a director in public companies.

**Avraham Podohzer, Avner Cohen and David Leviatan**-each has served for many years as a director and CEO of companies, and in this framework, have accumulated knowledge and experience in matters related to the capital market.

**Vered Reichman**-academic education in the areas of economics and business administration. She has served for many years as a CEO and serves as director in various companies, including a bank and economic institutions. She has vast knowledge and experience in business management and financial management.

## **9. Qualitative report on exposure to market risk and management techniques**

**A.** The individual in the Company who is responsible for managing market risks is the deputy CEO of the Company, Ms. Regina Ungar. The management of risks in companies in which the Company invests is carried out at the level of those companies, mainly by senior officers responsible for financial management.

### **B. Risk factors, market risks and external factors**

1. The Group operates in various areas of the capital market, which are characterized by high volatility, due to, among other things, the influence of governmental political, security and economic factors in Israel and the world, over which the Group has no control. This volatility affects the volume of the public's involvement in the capital market, the volume of security acquisitions in the primary markets, and as a result, the quantity of offerings being offered to the public.
2. There are many institutions that deal in the underwriting area and the management of offerings. In recent years, most of the activity in this area has been concentrated in the hands of a limited number of companies, with fierce competition among them. Since such competition affects the commission rates collected from the issuing companies and the determination of the values of the issuing companies, it is not inconceivable that, in the future, international investment banks, with organizational and economic resources that exceed those of the Group, will begin operating in this sector.
3. Legislative changes in the area of taxation of securities and changes in laws that relate to revisions in the conventional underwriting process in Israel, could have an effect on the activities of the Group, which cannot be anticipated on the date of issuance of this report.
4. Companies that operate in this sector have civil and criminal exposure in their activities as underwriters, and in particular, when they act as head managers of the underwriting consortium, including exposure to law suits due to misleading details in prospectuses which they have signed. In recent years, legal claims have been filed against different entities in the capital market in relation to their obligations as aforesaid.
5. The Group has made material investments in investee and other companies, part of whose shares are registered for trade on stock exchanges in Israel and/or the world, and accordingly, the market value of the companies is affected, inter alia, by changes and trends in Israeli and world capital markets. The changes in the

prices of securities of the public companies that are classified as long-term investments, do not by themselves affect the operating results, shareholders' equity, cash flows or value of the Company. In the case of a decrease in share prices, which are not considered as temporary, the profitability and asset value of the Company could be impaired, directly or indirectly.

6. Part of the companies in the Group rely in their operations on a limited number of significant suppliers and subcontractors, which supply components that are material to their operations. Failure of the suppliers and/or subcontractors to meet the demands of the companies, or termination of arrangements with them, could have a negative effect on these Group companies and endanger their ability to market their products.

7. A portion of the Group companies have investments in companies whose revenues are based, to a significant extent, on commitments with major customers, major suppliers or specific products, some of which are the result of successful tender offers. Failure to renew these commitments or to win tender offers could have a significant negative effect on the Group's operating results.
8. Part of the Group companies are involved in material law suits or legal proceedings, which if they were to lose, could have a significant effect on the operations of the Group over and above the financial exposure for which provisions have been recorded, and in certain cases, even on their value or likelihood of realization.
9. The Group owns holdings in companies in the advanced technology sector which necessitate significant investments in research and development of goods or services, where it is uncertain whether development will enable it to produce products or services which can be marketed on a commercial basis or whether they will be able to protect the technology and intellectual property that they own. Cumulative failure of these investments by the investees could also have an indirect negative effect on the Group's operating results.

In addition, the Group has made material investments in companies, part of which are in the initial stages of operation, which require large investments and which must cope with severe competitive conditions with well based competitors in the market.

10. The security condition in Israel and the world affects the Group's operating results.
11. The Group is not involved at all in the management of some of the companies in which it has invested, despite the fact that the cumulative amounts invested in them could be material.
12. The Company owns material holdings in companies, the operations of which are conditional upon the provisions of a license or concession from the Ministry of Communications, which could be revoked or not renewed. These licenses and concessions might even place restrictions on the Company regarding changes in ownership, limitations on holdings in competing companies and obligations by the Company to directly and/or indirectly invest in these companies.
13. The Group has residential, commercial and office real estate investments in Israel and abroad which are affected by prices of homes, commercial areas and offices in the real estate markets in Israel and overseas, the availability of sources of financing, and property policies of the government and other regulatory authorities.
14. Due to the variety of sources of credit of the Group and its affiliates, including those that operate abroad, there is exposure to changes in interest rates, in the rate of inflation and in currency rates that directly influence their liquid assets, liabilities and operating results. Also, an increase in the financial leverage of the Company and affiliates could increase these exposures.
15. The Group is exposed to changes in foreign currency rates, since it has assets and liabilities which are not in the reporting currency (balance sheet exposure) and

also, since the linkage bases of revenues and expenses do not always correspond (economic exposure).

16. Part of the Group companies are exposed to changes in raw material prices, other prices and other economic indices which have a material effect on the assets or liabilities of these companies, including the companies' liabilities to suppliers, customer debts to the companies, the value of inventories owned, etc.
17. The amounts budgeted by governmental authorities have an effect on the operations of certain Group companies.
18. Certain companies are exposed to numerous requirements of authorities that administer environmental conservation.
19. Some of the Group companies compete in a market along with competitors that have substantial resources for the financing of research and development, marketing, sales and technical support services. In addition, some of the Group companies operate in markets that are characterized by rapid technological changes and frequent introduction of new products by competitors that might change the consumption practices of the customers of these companies. The failure of these companies to meet competition, as described above, could affect their operating results in a negative manner.
20. To the best of the knowledge of the Company, as of the date of this report, a large number of funds specializing in private equity investments operate in Israel, as well as investment companies having broad and varied means of investment and expertise that operate in this area. Some of the funds specializing in private equity investments and the investment companies have assets and financial capabilities superior to those of the Group. Therefore, the Group finds itself competing with such investment and management factors, for the management of investments, joining investments and the size of investments in the companies of the portfolio.

### **C. Description of market risk management policies-**

Company Management scrutinizes and takes decisions, under changing conditions and circumstances, with regard to the volume and type of investments, the level of underwriting exposure and the extent and type of leverage of the Company.

The Company, as part of the regulation, supervision and management process of its investment in investee companies, is party to and receives updates of material matters in these companies from Company representatives who act as observers or board and committee members of those companies.

The Company periodically evaluates the composition of its investment portfolio, both from the operational viewpoint and from the standpoint of market value. Additionally, the Company examines the yields of its portfolio of monetary assets from time to time and compares it to market yields of various avenues while investigating the possibility of changing the composition of the portfolio or of realizing some of its channels.

The Company regards most of the investments in its investee companies as long-term investments, and therefore, does not execute hedging measures against changes in their values or against a decrease in the profitability of these companies.

In order to reduce the exposure to real changes in foreign currency and to changes in NIS interest rates of the Company and its investees, the Company acts to the extent possible to reduce exposure by maintaining a balanced linkage and interest balance sheet for the investee companies.

The risk management policies of the Company, as described above, are carried out principally for the Company itself. The Company does not stipulate or manage the risk policies of its investees. The setting of the risk management policies of the investee companies and the execution thereof are undertaken directly by those companies.

Also, the Company does not engage in activities intended to hedge market risks that derive from the operations of its investees and from the investee companies that they hold. Moreover, the Company does not manage the total accumulated market risks and, accordingly, does not offset the market risks of one investee company against those of another investee company.

#### **D. Means of supervision and implementation of policy**

The board of directors of the Company is furnished with a quarterly report on the current status of risk at the Company. In addition, as mentioned above, the significant investee companies are closely supervised on a regular basis through the representatives of the Company on the boards of directors and committees of the investees. The means of supervision and implementation of policies at those companies are under the responsibility of the managements and boards of directors of each investee company separately.

#### **E. Sensitivity analyses of financial instruments**

The model which was used to quantify the market risks is the sensitivity analysis model for market risks. The market risks that affect the sensitive financial instruments are as follows:

- Interest rates
- Increase in the Consumer Price Index
- Exchange rates of foreign currency / shekel
- Exchange rates of euro / dollar
- Market value of marketable securities

The sensitive financial instruments as of the date of the report are the holdings of the Company in cash and cash equivalents, trade accounts receivable and trade accounts payable in foreign currency, investments in marketable securities, long-term loans granted and received, as detailed in the notes to the financial statements.

According to the principles of the model, financial instruments were grouped on the basis of similar responses to market factors, since there was no significant loss of information that is required for purposes of understanding the exposure of the Company to market risks as a result of such grouping.

The book value of cash and cash equivalents, short-term investments, trade and other accounts receivable, short-term bank and other credit, and trade and other accounts payable approximate or are equal to their fair value.

The fair value of each of the sensitive financial instruments was determined as follows:

Cash and cash equivalents, trade accounts receivable and payable and loans granted or received in foreign currency – on the basis of the foreign currency/shekel exchange rate as of the balance sheet date.

Receivables and payables in dollars in a subsidiary, the functional currency of which is the euro – based on the exchange rate of the euro/dollar as of the balance sheet date.

Marketable securities – at their fair value on the balance sheet date.

Long-term shekel loans and debentures – based on the present value of the future payments (principal and interest) and based on the interest rates of the Company as of the balance sheet date, in relation to each reported financial instrument, the terms thereof, and the balance of the period to maturity.

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

As of the balance sheet date, a subsidiary of Urdan, Aloni, entered into forward transactions for the purchase of dollars versus the shekel in an amount of \$2.5 million, at exercise rates of between NIS 4.241 to 4.348 to the dollar. The fair value as of the balance sheet date is a loss of NIS 169 thousand.

The aforementioned transactions are for a period ending on May 31, 2007. The maximum derivatives position of Aloni was in call options to purchase \$2.5 million and was on April 30, 2006 and December 31, 2006. These transactions were for hedging purposes.

As of December 31, 2006, Polar Investments' maximum derivatives position in the reporting period was between January 1, 2006 and February 27, 2006, in call options to purchase €10 million against the sale of dollars, a put option to sell €10 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, The Company has no position in derivatives.

The maximum holding in derivatives of a subsidiary of Polar Investments during the reporting period was between October 30, 2006 and November 27, 2006 and was in forward transactions for the purchase of €2 million against the shekel. As of the date of this report, the subsidiary has no position in derivatives.

During 2005 and 2006, Polar Communications made an investment in a number of structured deposits that earn interest at rates of between 0% - 20%, contingent on the LIBOR rate. In addition, Polar Communications invested in structured deposits on which the interest is contingent upon changes in exchange rates, and investments in a number of structured deposits where the interest earned during the deposit period is contingent upon the rate of increase of certain shares on foreign stock exchanges. The deposits are presented at market value.

During the reporting period, Technologies entered into a forward transaction for the purchase of \$5 million and recorded an immaterial profit on this transaction. As of the balance sheet date, Technologies has no open transactions on the derivatives market.

In view of the existence of dollar liabilities on the books of the Company and the private companies under its control, the Company and the private companies under its control enter into transactions to hedge against the risk of a change in the exchange rate of the dollar.

As of December 31, 2006, the Company has an open forward transaction for the purchase of \$11 million for an amount of NIS 46.6 million. In addition, during the reporting period, the Company entered into a transaction for the purchase of \$10 million for an amount of NIS 45.3 million and a transaction for the purchase of €2 million for an amount of \$2.5 million. As a result of the aforementioned transactions, the Company recorded a loss of NIS 0.4 million in the reporting period.

As of the balance sheet date, Leader does not have any material holdings in derivatives except in respect of the Ma'of market as detailed below.

In addition to the above, the Company and Leader, by themselves and through a subsidiary of theirs, trade 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.

Subsequent to the balance sheet date, the Company and Leader decided to increase the volume of their exposure in respect of derivative activity on a Romanian stock exchange by €1.5 million, to be divided equally between the Company and Leader.

We present below a sensitivity analysis of the Group's financial instruments to changes that may take place in the risk factors to which the Group is exposed (NIS thousands):

Sensitivity to changes in interest rates:

	<b>Gains (Losses) from changes</b>		<b>Fair</b>	<b>Gains (Losses) from changes</b>	
	<b>Increase of 10%</b>	<b>Increase of 5%</b>	<b>Value</b>	<b>Decrease of 5%</b>	<b>Decrease of 10%</b>
<b>Dollar Interest</b>					
Long term debit balances	(197)	(98)	30,872	99	200
Loans to investee companies and others	(315)	(158)	49,269	159	319
Long term loans received	104	52	(33,770)	(52)	(107)
Convertible debentures (linked to the \$)	315	159	(20,253)	(161)	(326)
<b>Total</b>	<b>(93)</b>	<b>(45)</b>	<b>26,118</b>	<b>45</b>	<b>86</b>
<b>Pound Sterling Interest</b>					
Loan to an investee company	277	139	15,780	(138)	(276)
Long term loans received	17	9	(2,623)	(9)	(18)
<b>Total</b>	<b>294</b>	<b>148</b>	<b>13,157</b>	<b>(147)</b>	<b>(294)</b>
<b>NIS Interest</b>					
Long term loans granted (linked to the CPI)	325	162	14,837	(162)	(324)
Long term loans granted (unlinked)	(75)	(50)	3,179	115	102
Long term loans received (unlinked)	3,018	1,210	(206,433)	(2,760)	(4,099)
Long term loans received (linked to the CPI)	6,756	3,718	(488,719)	(1,951)	(4,058)
Debentures (linked to the CPI)	17,936	8,987	(715,052)	(9,342)	(17,893)
Convertible debentures (linked to the CPI)	766	391	(85,244)	(411)	(843)
<b>Total</b>	<b>28,726</b>	<b>14,418</b>	<b>(1,477,432)</b>	<b>(14,511)</b>	<b>(27,115)</b>
<b>Euro Interest</b>					
Loans to investee companies and others	(58)	(29)	10,370	29	59
Loans in foreign currency	552	221	(33,249)	(455)	(802)
<b>Total</b>	<b>494</b>	<b>192</b>	<b>(22,879)</b>	<b>(426)</b>	<b>(743)</b>
<b>Total Interest</b>	<b>29,421</b>	<b>14,713</b>	<b>(1,461,036)</b>	<b>(15,039)</b>	<b>(28,066)</b>

Sensitivity to market prices:

	<b>Gains (Losses) from changes</b>		<b>Fair</b>	<b>Gains (Losses) from changes</b>	
	<b>Increase of 10%</b>	<b>Increase of 5%</b>	<b>Value</b>	<b>Decrease of 5%</b>	<b>Decrease of 10%</b>
Investment in marketable securities	43,552	21,776	435,528	(21,776)	(43,552)
Structured deposits	1,493	747	14,930	(747)	(1,493)
<b>Total</b>	<b>45,045</b>	<b>22,523</b>	<b>450,458</b>	<b>(22,523)</b>	<b>(45,045)</b>

Sensitivity to changes in the exchange rate of NIS / foreign currency:

	<b>Gains (Losses) from changes</b>		<b>Fair</b>	<b>Gains (Losses) from changes</b>	
	<b>Increase of 10%</b>	<b>Increase of 5%</b>	<b>Value</b>	<b>Decrease of 5%</b>	<b>De crease of 10%</b>
<b>Dollar / NIS</b>					
Cash and cash equivalents	5,901	2,905	59,006	(2,950)	(5,901)
Short-term investments	14,545	7,272	145,447	(7,272)	(14,545)
Trade receivables	119	59	1,184	(59)	(119)
Loans to other companies	3,953	1,977	39,532	(1,977)	(3,953)
Suppliers and service providers	(341)	(171)	(3,414)	171	341
Short term loans received from banks	(297)	(148)	(2,965)	148	297
Long term loans received from banks	(152)	(76)	(1,521)	76	152
Long term loans received from others	(1,977)	(988)	(19,766)	988	1,977
Structured deposits	1,490	745	14,900	(745)	(1,490)
Long term loans granted	103	52	1,032	(52)	(103)
Forward transactions	5,533	2,682	57,017	(3,020)	(5,702)
<b>Total</b>	<b>28,877</b>	<b>14,354</b>	<b>290,452</b>	<b>(14,692)</b>	<b>(29,046)</b>
<b>Foreign currency (mainly Euro)</b>					
Cash	4,006	2,004	45,065	(2,004)	(4,006)
Short-term deposits	1,669	835	16,690	(835)	(1,669)
Short term credit	(3,160)	(1,581)	(31,602)	1,572	3,160
Short term credit (including current maturities of long term loans received from banks	(4,263)	(2,131)	(42,628)	2,131	4,263
<b>Total</b>	<b>(1,748)</b>	<b>(873)</b>	<b>(12,475)</b>	<b>864</b>	<b>1,748</b>

Sensitivity to changes in the exchange rate of Euro/dollar:

	<b>Gains (Losses) from changes</b>		<b>Fair</b>	<b>Gains (Losses) from changes</b>	
	<b>Increase of 10%</b>	<b>Increase of 5%</b>	<b>Value</b>	<b>Decrease of 5%</b>	<b>De crease of 10%</b>
Accounts receivable	3,004	1,502	30,040	(1,502)	(3,004)
Account payable	(1,164)	(582)	(11,644)	582	1,164
<b>Total</b>	<b>1,840</b>	<b>920</b>	<b>18,396</b>	<b>(920)</b>	<b>(1,840)</b>

**G. Report of linkage bases (in reported NIS millions):**

As of December 31, 2006	Financial balances			Other/ Non- financial balances	Total
	Unlinked	Linked to the CPI	In or linked to foreign currency		
<b>Assets:</b>					
Cash and cash equivalents	207.6	-	250.4	-	458.0
Marketable securities	277.1	2-.0	137.5	0.9	435.5
Short-term deposits and investments	-	3.8	70.7	-	74.5
Current maturities and loans granted	11.9	1.3	5.0	-	18.2
Trade accounts receivable	349.7	-	157.2	-	506.9
Accounts receivable and other debit balances	110.0	21.2	66.1	29.2	226.5
Inventory and work in progress	-	-	-	552.7	552.7
Real estate	-	-	-	482.1	482.1
Long-term investments in investee and other companies	49.0	236.1	104.9	201.9	591.9
Long-term deposits and loans granted	62.6	27.5	42.0	-	132.1
Fixed assets, net	-	-	-	602.0	602.0
Other assets and deferred expenses	-	-	-	170.0	170.0
<b>Total assets</b>	<b>1,067.9</b>	<b>309.9</b>	<b>833.8</b>	<b>2,038.8</b>	<b>4,250.4</b>
<b>Liabilities:</b>					
Short-term credit from banks and others	380.3	245.8	240.2	-	866.3
Suppliers and service providers	127.6	11.4	129.6	-	268.6
Accounts payable	170.6	59.8	61.7	0.5	292.6
Advances from customers	-	-	-	117.9	117.9
Long-term liabilities to banks and others	341.3	434.1	148.8	1.0	925.2
Debentures	-	528.8	60.1	-	588.9
Convertible debentures	-	98.8	30.4	-	129.2
Severance pay, net	0.3	-	-	17.5	17.8
Deferred taxes	-	-	-	12.0	12.0
Long-term liabilities	<b>1,020.1</b>	<b>1,378.7</b>	<b>670.8</b>	<b>148.9</b>	<b>3,218.5</b>
Minority interests	-	-	-	742.2	742.2
Receipts in respect of options issued in subsidiaries	-	-	-	19.3	19.3
Shareholders' equity	-	-	-	270.4	270.4
	<b>1,020.1</b>	<b>1,378.7</b>	<b>670.8</b>	<b>1,180.8</b>	<b>4,250.4</b>
	<b>47.8</b>	<b>(1,068.8)</b>	<b>163.0</b>	<b>858.0</b>	<b>-</b>

As of December 31, 2005	Financial balances			Other/ Non- financial balances	Total
	Unlinked	Linked to the CPI	In or linked to foreign currency		
<b>Assets:</b>					
Cash and cash equivalents	351.6	-	**203.2	-	554.8
Marketable securities	369.2	4.5	76.0	-	449.7
Short-term deposits and investments	-	2.0	**56.5	-	58.5
Current maturities and loans granted	-	15.2	-	-	15.2
Trade accounts receivable	**381.5	1.0	172.9	-	555.4
Accounts receivable and other debit balances	59.3	**26.0	**15.3	**42.3	142.9
Inventory and work in progress	-	-	-	**365.3	365.3
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	-	-	-	646.5	646.5
Other assets and deferred expenses	-	-	-	135.4	135.4
<b>Total assets</b>	<b>1,207.4</b>	<b>286.5</b>	<b>602.5</b>	<b>2,197.9</b>	<b>4,294.4</b>
<b>Liabilities:</b>					
Short-term credit from banks and others	412.8	329.5	127.5	-	869.8
Suppliers	121.3	9.0	110.0	0.7	241.0
Accounts payable	172.0	44.9	52.8	10.1	279.8
Advances from customers	98.2	-	-	-	98.2
Long-term liabilities to banks and others	366.2	483.5	198.3	-	1,048.0
Debentures	-	510.5	61.5	-	572.0
Convertible debentures	-	138.1	11.6	-	149.7
Severance pay	0.8	-	-	12.2	13.0
Deferred taxes	-	-	-	10.8	10.8
Long-term liabilities	<b>1,171.3</b>	<b>1,515.5</b>	<b>561.7</b>	<b>33.8</b>	<b>3,282.3</b>
Minority interests	-	-	-	***717.3	717.3
Receipts in respect of options issued in subsidiaries	1.8	-	-	***14.8	16.6
Debentures convertible into shares (quasi-equity)	-	-	-	11.7	11.7
Shareholders' equity	-	-	-	266.5	266.5
	<b>1.8</b>	<b>-</b>	<b>-</b>	<b>1,010.3</b>	<b>1,012.1</b>
	<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>34.3</b>	<b>(1,228.9)</b>	<b>40.8</b>	<b>1,153.8</b>	<b>-</b>

(\*\*) Reclassified

(\*\*\*) Restated

## 10. Critical accounting policies

The preparation of the financial statements of the Company and its subsidiaries in accordance with accounting principles generally accepted in Israel (GAAP) requires it to make estimates and to assume assumptions that affect the amounts presented in the financial statements. They include estimates that require judgment in an uncertain environment and materially affect the presentation of data in the financial statements.

The following is a description of some of the critical accounting assumptions that are used in preparation of the financial statements which, at the time that they are formulated, require the making of assumptions which in the circumstances and situations, involve significant uncertainties. The Company or subsidiaries, in deciding the determination of the estimates, rely upon past experience, various facts, external factors and reasonable assumptions under circumstances that conform to each estimate. The actual results are likely to differ from these estimates.

A. **Deferred taxes** - The consolidated financial statements of the Company include deferred tax assets with respect to losses for tax purposes from prior years, the realization of which is expected in the foreseeable future, inter alia, on the basis of anticipated Company earnings and on business plans of certain subsidiaries, according to which the realization of the tax benefits from the tax losses in these companies is expected. It is acknowledged that the actual fulfillment of these forecasts could vary and that, accordingly, the matter could affect the realization of the tax benefits in the future.

B. **Impairment of assets** - In accordance with the provisions of Accounting Standard No. 15 of the Israeli Accounting Standards Board, the Company and its subsidiaries, as the case may be, as of each balance sheet date, analyze whether events have occurred or changes in circumstances have taken place which indicate that there has been a decline in value of one or more of the non-monetary assets to which the Standard applies. If indications of a decline in value should exist, the Company and the subsidiaries consider whether, in such case, the amount at which the investment in the asset is presented is recoverable out of the anticipated cash flows from that asset, and to the extent necessary, record a provision for decline in value to the extent of the unrecoverable amount of the asset.

Determination of the estimates of the cash flows is based on past experience with this asset or similar assets, and on the best judgment of the Company and subsidiaries, as the case may be, of the economic conditions that will be present during the balance of the useful life of the asset and includes critical estimates such as the discount rate used in calculating the present value of those cash flows. In determining the net sales price of part of the assets, the Company uses valuations performed by appraisers for real estate assets. The estimates also take into account the condition of the market in the vicinity in which the asset is located.

Intensification of competition in the markets in which the Company and its subsidiaries operate might materially affect the cash flow forecasts, the balance of the useful lives and the determination of the net sales price of the asset. In addition, changes in the financial strength of investee companies, either as a result of reasons related to the activity of the companies themselves, or as a result of economic – security changes in the Israeli economy or the foreign economies in which the investees operate, may have an effect on the discount rate used in calculating the present value of the cash flows from those companies.

At the request of the Group, valuations were performed from time to time by external appraisers. The Group takes into consideration, among other things, the gamut of provisions of Standard No. 15, as reflected in the external valuations and the critical estimates.

In November 2006 Gmul Investment Company Ltd., an interested party in Polar Investments, enclosed a company valuation of Polar Investments in its financial statements as of September 30, 2006.

**C. Investments in technological companies** – In most cases, some of the Group companies, when assessing their investments in technological companies, use the value of the investee company that was reflected in the last round of investment, taking into consideration the period of time that lapsed since the latest round, the identity of those participating in the round, the size and results of operations of the investee since the investment was made. This estimate of company value is used extensively by the companies of the Group.

This estimate is critical, since implementation of the estimate involves uncertainty deriving from, among other things, the fact that it can change significantly in a relatively short period of time when dealing with technological companies, and any change therein may have a significant impact on the value of the investment of the Company in investee companies.

## **11. Contributions**

The Company regards contributions to the community as an important objective in its business activities and, therefore contributes in equal portions with Leader through the DS Fund, which is a registered association that has been recognized as a not-for-profit organization. The principal purpose of the association, as was set forth 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, intellectual institutions and enterprises, for scholarships to students, health, welfare and medicine”.

The amount of contributions of the Company and on a consolidated basis (including contributions of the Company’s subsidiaries) during the reporting period was approximately NIS 436 thousand and NIS 2,522 thousand, respectively. The amount of contributions last year, consolidated and Company, was NIS 357 thousand and NIS 1,653 thousand, respectively.

## **12. Disclosure regarding the internal auditor of the entity**

### **A. Identity of the internal auditor**

Ezra Yehuda, CPA, is the internal auditor of the Company and the private companies under its control and was appointed to this position on July 29, 1993. The internal auditor is the principal of an auditing firm that specializes in internal auditing. The firm has 17 years of experience in performing internal auditing in public companies and it specialized in a wide variety of areas of activity. The internal auditor is in compliance with the provisions of article 146(B) of the Companies Law – 1999 and the provisions of article 8 of the Internal Auditing Law – 1992 (hereinafter - the “Internal Auditing Law”). The internal auditor is not an employee of the Company, but provides it with external internal auditing services.

### **B. Scope of service of the internal auditor**

The scope of the work of the internal auditor and his staff in 2006 was 72 hours. Please note that the internal auditing of the investee companies is done by internal auditors of those companies, independently of the internal auditing of the Company. The internal auditor also serves as the internal auditor of Leader.

**C. Audit plan**

The annual and multi-year audit plan is presented by the internal auditor to the Company's Audit Committee. The Audit Committee scrutinizes the issues in consultation with management of the Company, and subsequently decides on the approval of the audit plan (with or without changes). The considerations that guide the Audit Committee are, among other things, the needs of the audit, the importance of the issues, the frequency in which the issues were examined in previous years and the recommendations of the internal auditor.

**D. The professional standards guiding the performance of the audit**

In accordance with the notification of the Company's internal auditor, he performed his audit in accordance with accepted professional standards under Section 4(b) of the Internal Audit Law, 1992.

**E. The identity of the person responsible for the internal auditor**

The Chairman of the Board is responsible for the internal auditor on the Company's behalf.

**F. Accessibility to information**

The internal auditor was furnished with documents and information prescribed by article 9 of the Internal Auditing Law – 1992 and was given access to information as per the same article, including continuous and unimpeded access to the Company's information system and financial data.

**G. Meetings of the Audit Committee during 2005**

During 2006, one audit report was prepared by the internal auditor. The discussion of the report's findings in the Company's Audit Committee took place on March 29, 2007.

H. The remuneration of the internal auditor in respect of the services provided by him in 2006 amounted to NIS 22 thousand. In the opinion of the board of directors, the remuneration of the internal auditor, as above, does not affect his professional discretion.

I. In the opinion of the board of directors of the Company, the extent and substance of the work program of the internal auditor are reasonable under the circumstances and are adequate to carry out the purposes of the internal audit, because the issues selected are material to the Company and were examined from different aspects.

**13. Peer review**

On July 28, 2005, the Israel Securities Authority issued a guideline in accordance with article 36A of the Israeli Securities Law – 1968 in the matter of disclosure pertaining to the agreement to conduct a peer review, the goal of which, according to the guideline, is to initiate a control process regarding the work of accounting firms, and an assessment of the existence of procedures required during the course of the work carried out by such firms, which would contribute to the existence of an advanced capital market.

The board of directors of the Company granted its consent to have the peer review carried out.

## 12. Auditing fees

The auditors of the Company and the private companies under its control in 2006 are Somekh Haikin, CPAs (Isr.).

We present below a breakdown of the auditing fees of the material subsidiaries of the Company, in respect of auditing services, audit-related services and tax work in 2006 and 2005:

### 2006

Company name	Accounting firm	In respect of audit, related and tax services		For other services	
		Hours	NIS Thousands	NIS Thousands	Details
The company and its privately-held companies	Somekh Haikin	3,400	442		
The company and its privately-held companies	Brightman		-	38	Mainly tax services
The company and its privately-held companies	Kost		-	34	Mainly tax services
Technologies and its privately-held companies	Somekh Haikin	1,636	325		
Danbar Technologies Ltd.	Brightman	517	74		
Platinum Fund	Kost	582	61		
Persay Inc.	Brightman	485	70		
Leader and its privately-held companies	Kost	3,060	478	64	Tax services
Leader Capital Markets	Fahn Kanne	670	140	180	Mainly for a prospectus
Leader Capital Markets	Brightman	660	140	410	Mainly for special tax services and a prospectus
Urdan and private companies	Brightman	4,000	644	7	
Itong and private companies	Brightman	2,500	395	68	
Nirlite and private companies	Brightman	2,160	370	-	
Aloni and private companies	Brightman	600	135	-	
Polar Communications (*)	Brightman	1,350	150	89	
Barak Printing Ltd.	Kost	250	34	-	
Polar Investments	Somekh Haikin	2,172	385	184	Mainly for preparation of prospectus that was not completed and special tax services
Polar Real Estate	Zohar and Zohar	2,583	288	34	Special tax services
Polar International Real Estate	Zohar and Zohar	2,687	207	154	Various services including representation at VAT
Telit	Brightman	5,066	1,271	77	Mainly international consulting
Telit	Baker Tilly	343	132	-	
Ophir	Kesselman & Kesselman	275	43	-	
Hazera	Kesselman & Kesselman	577	89	-	

(\*) In addition, the professional fees of Nipson and its subsidiaries paid to foreign auditors amounted to NIS 1.6 million in 2006.

## 2005

Company name	Accounting firm	In respect of audit, related and tax services		For other services	
		Hours	NIS Thousands	NIS Thousands	Details
The company and its privately-held companies	Somekh Haikin	3,800	430		
The company and its privately-held companies	Somekh Haikin	850	-	200	Prospectus and financial statements of foreign company
Technologies and its privately-held companies	Somekh Haikin	1,322	253		
Technologies and its privately-held companies	Somekh Haikin	942		280	Mainly prospectus
Danbar Technologies Ltd.	Brightman		74		
Platinum Fund	Kost		77		
Leader and its privately-held companies	Kost	2,042	344	220	Mainly prospectus and tax services
Urdan and private companies	Brightman	4,000	644	38	
Itong and private companies	Brightman	2,500	380	96	
Nirlite and private companies	Brightman	2,160	335	-	
Aloni and private companies	Brightman	600	135	-	
Polar Investments	Somekh Haikin	2,105	375	24	Mainly for special tax services
Polar Real Estate	Zohar and Zohar	2,783	248	-	
Polar International Real Estate	Zohar and Zohar	2,903	163	153	Mainly for submission of prospectus
Telit	Baker Tilly	2,625	644	78	Mainly for submission of prospectus
Telit	Brightman	3,700	839	233	Mainly for submission of prospectus
Ophir	Kesselman & Kesselman	900	146	42	Mainly for special tax services
Hazera	Kesselman & Kesselman	536	89	-	

### 14. Adoption of International Financial Reporting Standards (IFRS)

In July 2006, the Israeli Accounting Standards Board issued Accounting Standard No. 29 – “*Adoption of International Financial Reporting Standards (IFRS)* (hereinafter - the “Standard No. 29”). Standard No. 29 stipulates that companies that are subject to the Israeli Securities Law – 1968 and that are required to report according to the regulations of that law, are to prepare their financial statements for periods beginning as from January 1, 2008 (i.e., commencing with the financial statements of the first quarter of 2008) according to IFRS.

According to the provisions of Standard No. 29, early adoption of the Standard is permitted as from financial statements published after July 31, 2006.

Initial adoption of International Financial Reporting Standards shall be done in accordance with the provisions of IFRS 1- “*Initial Adoption of IFRS*”. In the first year of adoption of IFRS, the Company is required to present comparative figures for one year only in financial statements that are presented in accordance with IFRS.

In addition, Standard No. 29 requires companies that present their financial statements for the first time pursuant to IFRS, for periods commencing on or after January 1, 2008, to include in a note to the 2007 financial statements the balance sheet data as of December 31, 2007 and the income statement data for the year then ended after having applied to such data the rules of recognition, measurement and presentation of IFRS.

The adoption process began with the identification of the expected significant qualitative effects of the transition of the reporting format to IFRS on the financial statements of the Company. The goal of this phase is the identification of the major relevant changes that are expected to have a possible impact on the Company’s financial statements.

At present, the Company is assessing the consequences of the transition to IFRS. However, at this stage, the Company is unable to estimate the quantitative impact of adoption of IFRS on its financial statements.

Further to the issuance of Standard No. 29, the Company set up a task force to handle the process of adopting international standards at the Company. The head of the task force is the senior person in the Company responsible for financial matters, who set out milestones for the transition to reporting in accordance with IFRS.

The following is a summary of the activities and work phases as set forth by the task force –

- Study of the IFRS by the relevant employees at the Company and a more in-depth assessment of the IFRS that are particularly relevant to the Company.
- Location and identification of initial discrepancies between accounting principles generally accepted in Israel that are currently implemented by the Company and those IFRS that are relevant to the Company.
- Assessment of the possible alternatives under IFRS to the accounting policies to be selected by the Company.
- Selection and formulation of the Company's accounting policies under IFRS, including those applicable to the investees of the Company.
- A qualitative assessment of the major effects expected to derive to the Company as a result of the adoption of IFRS.
- Assessment of the impact in the financial statements as of the transition date (January 1, 2007) as a result of adoption of IFRS 1, including an assessment of the reliefs and prohibitions set out as part of IFRS 1.
- A quantitative assessment of the major accounting consequences expected to derive to the Company as a result of the adoption of IFRS, on the basis of the accounting policy selected and the reliefs that it was decided to adopt.
- Preparation of a balance sheet and income statement as of December 31, 2007 in accordance with IFRS.

As of the publication of this report, the Company had started the process of studying the IFRS, locating, identifying and mapping the initial discrepancies between accounting principles generally accepted in Israel and IFRS that are relevant to the Company, selecting the reliefs to be adopted in accordance with IFRS 1, and partially selecting an accounting policy, including conducting a qualitative assessment of the effects expected to derive to the Company as a result of the adoption of IFRS.

The following is a description of the issues identified to date, expected to have a significant impact on the consolidated financial statements of the Company as a result of the transition to reporting under IFRS, including changes that may occur in the accounting policy of the Company as a result of such transition:

- **Investments in securities**

According to accounting principles generally accepted in Israel, investments in financial instruments are treated as follows:

Marketable financial assets held as a current investment – Investments in marketable securities held for trading purposes, such as short-term investments, are recognized at fair value.

Permanent investments and non-negotiable financial assets – Investments in marketable securities that are not current investments, such as marketable debentures, and investment in non-negotiable securities, such as unlisted shares and unlisted debentures, are recognized at cost (or adjusted cost when dealing with debentures), net of a decline in value.

**According to IFRS, the Group classifies its investments in securities according to the following categories:**

1. Financial assets presented at fair value through the income statement - This group includes financial assets held for trading purposes and financial assets designated by Company Management upon initial recognition as financial assets presented at fair value through the income statement.
2. Financial assets available for sale – are non-derivative instruments that were designated to this category or that were not classified as current investments. These assets are presented as part of non-current assets, except for assets which Management intends on realizing within 12 months following the balance sheet date, which are presented as part of current assets. Changes in the fair value of financial assets available for sale are carried directly to shareholders' equity.

**- Liability for employee severance benefits:**

According to IFRS, the liability for employee severance pay is computed in accordance with IAS 19 "Employee Benefits", on the basis of the present value of the "defined benefit liability" measured on the basis of actuarial estimates and discounted expected cash flows. According to accounting principles generally accepted in Israel, the liability for employee severance benefits is calculated in its full amount, not on the basis of discount rates, under the assumption that all employees are terminated at the balance sheet date. In other words, the liability reflects the product of the number of years worked, by the last monthly salary of the employees (one month's pay for each year of seniority), as of the balance sheet date.

**- Recognition of revenues from the construction of buildings for sale**

According to IFRS, revenues are recognized from the sale of buildings constructed by the Company when the construction has been completed and the entire risk has been transferred to the purchaser. According to accounting principles generally accepted in Israel, revenues from sales of buildings are recognized on the percentage of completion method, in accordance with Standard No. 2 of the Israeli Accounting Standards Board.

**- Leases from the Israel Lands Administration**

According to IFRS, leases from the Israel Lands Administration for a period of 49 years are classified as operating leases. In other words, the discounted amounts paid, which constitute advance lease fees, will be depreciated on the straight line method over the rights period. According to accounting principles generally accepted in Israel, the discounted amounts are presented as part of the Company's fixed assets, as property and are not depreciated.

**- Convertible instruments with a conversion price that is linked to the Israeli Consumer Price Index**

According to IFRS, option warrants issued to investors with an exercise price that is linked to the Index are classified as liabilities and are measured at fair value, with changes in fair value carried to the income statement. According to accounting principles generally accepted in Israel, these option warrants are presented as part of the company's shareholders' equity at the value at which they were initially recognized.

In addition, according to IFRS, liabilities convertible into shares, linked to the Index, are classified as liabilities. For measurement purposes, the amount of the liability must be broken down into two components: the liability component without the conversion right, which is measured on the basis of unamortized cost in accordance with the effective interest method, and the conversion option which is measured at fair value, with the changes in fair value being carried to the income statement. According to accounting principles generally accepted in Israel, these liabilities are treated as complex instruments and are split into a capital component and a liability component.

**- Contingent liabilities and recognition of provisions**

According to IFRS, a provision should be recognized when it is more likely than not that the company has an existing commitment at the balance sheet date, is expected to have to use economic resources to settle the commitment, and the amount of the provision can be reliably measured. In addition, a provision should be computed on the basis of the best estimate of the expenditure that will be required to settle the commitment that exists at the balance sheet date. According to accounting principles generally accepted in Israel, a company must recognize a provision when it is probable that it will make use of economic resources to settle the commitment at the expected amount of the loss. In addition, according to IFRS, whereas an insurance indemnification is recognized separately from the provision, and only when there is a virtual certainty that the company is entitled to receive the indemnification, according to accounting principles generally accepted in Israel, under certain circumstances, the company will take into consideration the existence of insurance indemnification when computing the provisions.

- **Embedded derivatives**

According to IFRS, embedded derivatives must be segregated from hybrid derivatives. Embedded derivatives that were segregated are measured at fair value, with changes in fair value being carried to the income statement. According to accounting principles generally accepted in Israel, no segregation is required between embedded derivatives and hybrid derivatives.

- **Acquisition of subsidiaries and consolidated financial statements**

According to IFRS, upon the acquisition of a subsidiary, surplus cost (excluding goodwill) must be allocated at full fair value at the date of purchase, and minority rights are to be presented on the basis of their share of the fair value of the subsidiary. According to accounting principles generally accepted in Israel, the purchaser allocates surplus cost only on the basis of the acquired part of the subsidiary and the minority rights are presented on the basis of their share in the net book value of the assets. In addition, according to IFRS, the minority rights are presented as part of shareholders' equity, while according to accounting principles generally accepted in Israel, the share of the minority in the results of the subsidiary are an expense in the income statement of the company and the minority rights in the company's shareholders' equity are presented outside of the shareholders' equity of the company.

- **A transaction between a subsidiary and the controlling shareholder therein**

According to IFRS, equipment purchased in the past by a subsidiary of the company from the controlling shareholder in the subsidiary is to be recorded at the transaction price (that reflects fair value as of the date of purchase) at the date of purchase and not at the book value on the books of the controlling shareholders as presented in the current consolidated financial statements of this subsidiary.

- **Deferred income on issuance to a third party**

According to accounting principles generally accepted in Israel, a gain deriving to the company on an issuance to a third party of an affiliated company in the R&D stage which has not yet made any significant sales, should be recorded as deferred income and carried to the income statement in equal shares at the higher of and in the aggregate of a three year period or up to the share of the company in the losses of this affiliate during the relevant period. According to IFRS, the gain on an issuance to a third party deriving as above should be immediately carried to the income statement and not deferred.

- **Share-based payments**

According to IFRS, in connection with capital grants to employees made on or subsequent to November 7, 2002 and which have not yet vested as of January 1, 2007, the value of the work services received from them in return that were measured at the date of the grant on the basis of the fair value of the capital instruments that were granted to the employees is expensed over the vesting period of right of the employee to exercise or receive the relevant capital

instruments. Concurrent with the recording of every periodic part of the expense, a corresponding increase is recorded to a capital reserve, presented as part of the shareholder's equity of the company.

According to accounting principles generally accepted in Israel, the company implements the above treatment regarding grants made subsequent to March 15, 2005 only.

For information pertaining to the expected impact of the adoption of Israeli accounting standards (which is based on the international standards on the issues) on the issues of inventory, fixed assets and investment real estate commencing on January 1, 2007, see Note 2AA of the financial statements "Disclosure of the effects of new accounting standards in the period prior to implementation".

At present, it seems that, except for the effects set out above, implementation of IFRS is not expected to have a material impact on the Company. Please note that the information regarding the consequences of the transition to IFRS, as above, is forward-looking information. It is quite possible that these assessments and forecasts will not be realized or will be realized in a manner that differs from the assessments and forecasts of the Company, as a result of reasons that are not necessarily controlled by the Company.

The Company thanks its employees for their involvement with the Company and its shareholders for their trust.

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**Itschak Shrem-Chairman of the Board**

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**Yair Fudim, CEO and Director**

**Date:** March 29, 2007

**Balance Sheets as at December 31**

	<b>Consolidated</b>		<b>Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>NIS thousands</b>	<b>NIS thousands</b>	<b>NIS thousands</b>	<b>NIS thousands</b>
<b>Current assets</b>				
Cash and cash equivalents	<b>458,000</b>	* 554,849	<b>17,361</b>	54,688
Deposits and short-term investments	<b>74,429</b>	* 58,480	-	-
Marketable securities	<b>435,498</b>	449,732	<b>68,499</b>	64,345
Current maturities and loans receivable	<b>18,238</b>	* 15,120	<b>109</b>	89
Trade receivables	<b>506,941</b>	555,417	<b>259</b>	242
Other receivables	<b>226,527</b>	* 142,858	<b>13,697</b>	14,014
Inventory and work in process	<b>552,693</b>	* 365,298	-	-
	<b>2,272,326</b>	2,141,754	<b>99,925</b>	133,378
<b>Real estate</b>	<b>482,143</b>	634,111	-	-
<b>Investments and long-term loans</b>				
Investments in investee and other companies	<b>591,880</b>	622,154	<b>357,728</b>	** 330,946
Deposits and loans	<b>132,110</b>	114,415	<b>3,725</b>	391
	<b>723,990</b>	736,569	<b>361,453</b>	331,337
<b>Fixed assets</b>	<b>601,996</b>	* 646,493	<b>22,383</b>	23,728
<b>Other assets and deferred expenses</b>	<b>169,956</b>	135,401	-	2,148
	<b>4,250,411</b>	4,294,328	<b>483,761</b>	490,591

\* Reclassified

\*\* Restated

Date of approval: March 29, 2007

**Balance Sheets as at December 31**

	<b>Consolidated</b>		<b>Company</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>NIS thousands</b>	<b>NIS thousands</b>	<b>NIS thousands</b>	<b>NIS thousands</b>
<b>Current liabilities</b>				
Credit from banks and others	<b>866,307</b>	869,677	<b>36,255</b>	50,939
Suppliers and service providers	<b>268,600</b>	241,005	<b>339</b>	476
Accounts payable and credit balances	<b>292,584</b>	279,799	<b>22,768</b>	26,317
Customer deposits	<b>117,864</b>	98,212	-	-
	<b>1,545,355</b>	1,488,693	<b>59,362</b>	77,732
<b>Long-term liabilities</b>				
Credit from banks and others	<b>925,172</b>	1,048,030	<b>43,695</b>	33,401
Debentures	<b>588,941</b>	571,945	<b>87,654</b>	89,141
Convertible debentures	<b>129,219</b>	149,692	<b>21,947</b>	11,598
Employee retirement benefit, net	<b>17,723</b>	13,030	<b>670</b>	460
Deferred tax	<b>12,035</b>	10,821	-	-
	<b>1,673,090</b>	1,793,518	<b>153,966</b>	134,600
<b>Minority interest</b>	<b>742,203</b>	717,315	-	-
<b>Convertible debentures</b>	-	11,727	-	11,727
<b>Receipts from share options issued by subsidiaries</b>	<b>19,330</b>	* 16,543	-	-
<b>Shareholders' equity</b>	<b>270,433</b>	* 266,532	<b>270,433</b>	* 266,532
	<b>4,250,411</b>	4,294,328	<b>483,761</b>	490,591

\* Restated

**Statements of Operations for the Year Ended December 31**

	Consolidated			Company		
	For the year ended December 31			For the year ended December 31		
	2006	2005	2004	2,006	2005	2004
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
<b>Income</b>						
Sales, management, consultancy services and Underwriting	<b>1,946,904</b>	1,903,522	1,814,020	<b>6,275</b>	7,979	9,216
Gain on marketable securities, net	<b>42,389</b>	66,779	44,623	<b>2,407</b>	16,006	14,870
Gain on sale of investments, loans and assets, net	<b>126,197</b>	357,164	158,962	<b>4,188</b>	8,600	2,369
Company's equity in earnings of investees, net	<b>8,877</b>	-	37,659	<b>37,872</b>	* 61,615	54,188
	<b>2,124,367</b>	2,327,465	2,055,264	<b>50,742</b>	94,200	80,643
<b>Costs and expenses</b>						
Cost of sales and services	<b>1,465,929</b>	* 1,464,884	1,365,868	<b>688</b>	1,428	2,224
Selling and marketing	<b>230,810</b>	* 202,748	173,808		-	-
Administrative and general	<b>267,272</b>	* 269,355	251,550	<b>19,923</b>	23,475	18,669
Loss on sale of investment loans and assets, net						
Company's equity in losses of investees, net	-	21,942	-	-	-	-
Financing expenses, net	<b>139,256</b>	160,983	140,934	<b>8,189</b>	11,094	11,348
	<b>2,103,267</b>	2,119,912	1,932,160	<b>28,800</b>	35,997	32,241
<b>Profit (loss) from operations before taxes on income</b>	<b>21,100</b>	207,553	123,104	<b>21,942</b>	58,203	48,402
Tax benefit (taxes on income)	<b>(35,354)</b>	*(67,833)	(16,494)	<b>(195)</b>	214	-
<b>Profit (loss) from operations after taxes on income</b>	<b>(14,254)</b>	139,720	106,610	<b>21,747</b>	58,417	48,402
Minority interest in (earnings) losses of subsidiaries, net	<b>36,001</b>	*(81,303)	(58,208)	-	-	-
Earnings before cumulative effect as at beginning of year of change in accounting principles, net	<b>21,747</b>	58,417	48,402	<b>21,747</b>	58,417	48,402
Cumulative effect as at beginning of year of change in accounting principles, net	<b>619</b>	-	-	<b>619</b>	-	-
<b>Net earnings for the year</b>	<b>22,366</b>	58,417	48,402	<b>22,366</b>	58,417	48,402

\* Restated

**Statements of Operations for the Year Ended December 31 (cont'd)**

	<b>December 31 2006</b>	<b>December 31 2005</b>	<b>December 31 2004</b>
	<b>(Unaudited)</b>	<b>(Unaudited)</b>	<b>(Audited)</b>
	<b>NIS thousands</b>	<b>NIS thousands</b>	<b>NIS thousands</b>
<b>Net earning per share capital:(*)</b>			
Basic earning per share:			
Earning from operating activities	<b>1.21</b>	3.20	2.70
Earnings from cumulative effect as at beginning of year of change in accounting principles, net	<b>0.03</b>	-	-
Net earnings	<b>1.24</b>	3.20	2.70
Diluted earnings per share:			
Earning from operating activities	<b>0.60</b>	2.39	2.21
Earnings from cumulative effect as at beginning of year of change in accounting principles, net	<b>0.03</b>	-	-
Net earnings	<b>0.63</b>	2.39	2.21

(\*) Restated

**Statement of Shareholders' Equity**

	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, 2006</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>Changes in 2006:</b>									
Balance of negative goodwill as at January 2, 2006 (**)	-	-	-	-	-	-	-	1,230	1,230
Creation of capital component of convertible debentures (**)	-	-	592	-	-	-	-	-	592
Purchase of company shares	-	-	-	-	-	(4,064)	-	-	(4,064)
Capital reserves of investee company	-	455	-	-	-	-	-	-	455
Conversion of option warrant into company shares by employee	117	(117)	-	-	-	-	-	-	-
Repayment of loan to employees for purchase of shares	-	-	-	-	37	-	-	-	37
Benefit due to allocation of option warrants	-	-	64	-	-	-	-	-	64
Dividend	-	-	-	-	-	-	(14,379)	-	(14,379)
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	-	(2,400)	-	-	-	-	(2,400)
Dividend declared subsequent to balance sheet date	-	-	-	-	-	-	30,000	(30,000)	-
Net profit for the year	-	-	-	-	-	-	-	22,366	22,366
<b>Balance as at December 31, 2006</b>	<b>25,665</b>	<b>166,877</b>	<b>3,857</b>	<b>(2,502)</b>	<b>(1,162)</b>	<b>(11,364)</b>	<b>30,000</b>	<b>59,062</b>	<b>270,433</b>

\* Reclassified

\*\* Initial implementation of accounting standard.

**Statement of Shareholders' Equity**

	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</b>	25,360	164,850	-	8,670	(3,194)	(2,451)	-	30,559	223,794
<b>Changes in 2005:</b>									
Issuance of options	-	-	3,201	-	-	-	-	-	3,201
Purchase of company shares	-	-	-	-	-	(4,849)	-	-	(4,849)
Capital reserves of investee company	-	486	-	-	-	-	-	-	486
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	-	-	-	(8,772)	-	-	-	-	(8,772)
Dividend declared subsequent to balance sheet date	-	-	-	-	-	-	* 14,379	*(14,379)	-
Net profit for the year	-	-	-	-	-	-	-	** 58,417	** 58,417
<b>Balance as at December 31, 2005</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

**Statement of Shareholders' Equity (cont'd)**

	<u>Share capital</u>	<u>Premium on shares and capital reserves</u>	<u>Adjustments from the translation of financial statements of autonomous foreign investees</u>	<u>Loans to employees for purchase of shares</u>	<u>Company shares held by the Company and subsidiary</u>	<u>Retained earnings</u>	<u>Total</u>
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
<b>Balance as at January 1, 2004</b>	24,923	162,223	4,981	(3,194)	(4,691)	(17,464)	166,778
<b>Changes in 2004:</b>							
Sale of Company shares	-	-	-	-	2,240	(379)	1,861
Conversion of debentures into shares of the Company	437	2,876	-	-	-	-	3,313
Changes in capital reserves in respect of investee companies	-	(249)	-	-	-	-	(249)
Adjustments from the translation of financial statements of autonomous foreign investees	-	-	3,689	-	-	-	3,689
Net profit for the year	-	-	-	-	-	(**)48,402	(**)48,402
<b>Balance as at December 31, 2004</b>	<u>25,360</u>	<u>164,850</u>	<u>8,670</u>	<u>(3,194)</u>	<u>(2,451)</u>	<u>30,559</u>	<u>223,794</u>

**Statements of Cash Flows for the Year Ended December 31**

	Consolidated			Company		
	For the year ended December 31			For the year ended December 31		
	2006	2005	2004	2006	2005	2004
NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	
<b>Cash flows from operating activities:</b>						
Net profit (loss) for the year	<b>22,366</b>	* 58,417	48,402	<b>22,366</b>	* 58,417	48,402
Adjustments required to reconcile cash from operating activities (Annex A)	<b>3,373</b>	*(102,362)	(288,088)	<b>(36,508)</b>	*(88,341)	(68,703)
<b>Net cash inflow (outflow) attributed to continued operations</b>	<b>25,739</b>	(43,945)	(239,686)	<b>(14,142)</b>	(29,924)	(20,301)
<b>Cash flows from investing activities:</b>						
Acquisition of fixed assets, real estate and amounts charged to projects under construction and other assets	<b>(149,061)</b>	** (229,856)	(83,608)	<b>(137)</b>	(623)	(564)
Proceeds from sale of fixed assets and other assets	<b>35,254</b>	** 109,737	178,266	<b>135</b>	238	195
Proceeds (purchase) of marketable securities, short-term investment and deposits, net	<b>59,856</b>	(150,711)	91,560	<b>2,388</b>	11,874	23,266
Investment in investee and other companies (including through loans and capital notes, net)	<b>(129,983)</b>	(128,333)	(144,644)	<b>(21,981)</b>	(9,818)	(34,080)
Repayment (granting) of loans and deposit, net	<b>(42,049)</b>	** (60,418)	(42,021)	-	-	30,273
Proceeds from sale of investments in investee and other companies	<b>274,213</b>	467,535	367,532	<b>10,287</b>	49,881	26,797
Initially fully or proportionately consolidated companies and acquisition of activities (Annex C)	<b>(30,470)</b>	7	(1,445)	-	-	-
Companies formerly fully or proportionately consolidated no longer consolidated and activities sold (Annex D)	<b>(121)</b>	6,689	665	-	-	-
Company initially consolidated (Annex E)	<b>(13,113)</b>	(2,690)	-	-	-	-
<b>Net cash inflow (outflow) attributed to continued investment activities</b>	<b>4,526</b>	11,960	366,305	<b>(9,308)</b>	51,552	45,887

\* Restated

\*\* Reclassified

**Statements of Cash Flows for the Year Ended December 31 (cont'd)**

	Consolidated			Company		
	For the year ended December 31			For the year ended December 31		
	2006	2005	2004	2006	2005	2004
NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	
<b>Cash flows from financing activities:</b>						
Repayment of loans for the purchase of company shares	37	1,995	-	37	1,995	-
Issuance of shares and option warrants	-	3,201	-	-	3,201	-
Sell of Company's shares	-	-	1,861	-	-	-
Purchase of Treasury shares	(4,064)	(4,849)	-	-	-	234
Issue of convertible bonds in Company's shares, net	-	67,912	-	-	94,912	-
Repayment of long-term loans and capital notes, net	(81,814)	(238,869)	(109,918)	7,427	(16,362)	(18,675)
Issue of debentures and convertible debentures in consolidated companies, net	80,315	63,479	-	-	-	-
Repayment of debentures and convertible debentures in consolidated companies	(222,101)	(131,989)	(85,342)	-	-	-
Dividend to minority	(47,272)	(35,277)	(23,603)	-	-	-
Issue of marketable securities of subsidiaries	77,427	725,081	55,073	-	-	-
Liability for financial lease	-	-	(53,850)	-	-	-
Dividend	(14,379)	(9,131)	-	(14,379)	(9,131)	-
Receipt (repayment) of short-term credit, net	75,279	(52,963)	11,592	(6,962)	(51,412)	1,980
Issuance of capital in proportionate consolidated Partnership (Annex F)	6,718	-	-	-	-	-
<b>Net cash inflow (outflow) attributed to continued financing activities</b>	<b>(129,854)</b>	<b>388,590</b>	<b>(204,187)</b>	<b>(13,877)</b>	<b>23,203</b>	<b>(16,461)</b>
Translation differences with respect to cash balances in autonomous investee companies	2,740	(13,127)	(579)	-	-	-
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(96,849)</b>	<b>343,478</b>	<b>(78,147)</b>	<b>(37,327)</b>	<b>44,831</b>	<b>9,125</b>
Balance of cash and cash equivalents at beginning of year	554,849	211,371	289,518	54,688	9,857	732
<b>Balance of cash and cash equivalents as at end of year</b>	<b>458,000</b>	<b>554,849</b>	<b>211,371</b>	<b>17,361</b>	<b>54,688</b>	<b>9,857</b>

**Statements of Cash Flows for the Year Ended December 31 (cont'd)**

	Consolidated			Company		
	For the year ended December 31			For the year ended December 31		
	2006	2005	2004	2006	2005	2004
NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	
<b>Annex A -</b>						
<b>Adjustments required to reconcile cash from operating activities</b>						
<b>Income and expenses not involving cash flows:</b>						
Depreciation and amortization	53,247	78,033	55,293	1,442	1,940	1,396
Company's equity in losses (earnings) of investee companies less of dividend received, net	(10,100)	* 26,974	(19,897)	(22,950)	*(28,822)	(45,966)
Deferred taxes, net	(6,695)	42,011	2,769	195	-	-
Minority interest in earnings (losses) of subsidiaries, net	(36,001)	* 81,303	58,208	-	-	-
Loss (gain) on marketable securities, net	(34,142)	(56,703)	(18,669)	(2,407)	(16,006)	(14,870)
Increase (decrease) in liability for employee severance benefits, net	3,475	(3,450)	25	210	143	1
Loss (gain) on sale and amortization of long-term investments and assets, net	(43,348)	(366,166)	(162,584)	(4,179)	(7,379)	(3,140)
Expenses (income) from financing activities	11,569	27,405	8,088	(644)	(1,446)	28
Cost of based share payment	526	-	-	64	-	-
Other expenses	-	-	6,782	-	-	-
Expenses due to option warrants for employee	-	* 597	-	-	-	-
Cumulative effects as at beginning of year of change in accounting principles, net	(619)	-	-	(619)	-	-
<b>Changes in asset and liability items:</b>						
Decrease (increase) in trade receivables and other receivables	131	** (23,533)	(143,443)	738	(39,877)	(8,678)
Decrease (increase) in inventory and work in process, net	38,848	(23,869)	(21,927)	-	-	-
Increase (decrease) in suppliers and service providers	26,482	* 115,036	(52,733)	(8,358)	3,106	2,526
	<b>3,373</b>	<b>(102,362)</b>	<b>(288,088)</b>	<b>(36,508)</b>	<b>(88,341)</b>	<b>(68,703)</b>

\* Reclassified

**Statements of Cash Flows for the Year Ended December 31 (cont'd)****Annex B - Non cash transactions**

	Consolidated			Company		
	For the year ended December 31			For the year ended December 31		
	2006	2005	2004	2006	2005	2004
	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands	NIS thousands
Commitment to invest in other companies	-	84	527	-	-	-
Purchase of fixed assets on credit	<b>2,609</b>	1,468	2,481	-	-	-
Purchase of the minority interest in a subsidiary against the issuance of shares, options and debentures of another subsidiary	-	-	-	-	-	-
Amounts receivable	-	-	-	-	-	-
Conversion of debentures into shares of Company	-	1,391	3,313	-	1,391	3,313
Conversion of debentures into shares of subsidiary	<b>18,545</b>	32,532	-	-	-	-
Sale of fixed assets on credit	<b>49</b>	10,438	-	-	-	-
Proceeds from sale of investment in investee	<b>10,957</b>	-	1,290	<b>10,957</b>	-	703
Amounts receivable from sale of land, leased building and fixed assets	<b>579</b>	-	-	-	-	-
Exercise of option warrants in subsidiaries	<b>229</b>	-	-	-	-	-

**Statements of Cash Flows for the Year Ended December 31 (cont'd)****Annex C - Initially fully or proportionately consolidated companies and acquisition of activities**

	Consolidated		
	2006	2005	2004
	NIS thousands	NIS thousands	NIS thousands
Working capital, net (excluding cash and cash equivalents)	(6,947)	1,279	2,105
Investments, long-term loans and fixed assets	(25,844)	-	(3,550)
Other assets and deferred expenses	-	-	-
Long-term liabilities	-	2,421	-
Excess cost	-	(10,502)	-
Balance of investment in companies as at date of initial consolidated	-	8,235	-
Minority share in deficiency	2,321	(1,426)	-
	<b>(30,470)</b>	<b>7</b>	<b>(1,445)</b>

**Annex D - Companies previously consolidated, fully or proportionately, which are no longer consolidated and activity sold**

	Consolidated		
	2006	2005	2004
	NIS thousands	NIS thousands	NIS thousands
Working capital, net (excluding cash and cash equivalents)	(54)	(30,672)	(664)
Investments and long-term loans	-	16,467	-
Fixed and other assets	2,557	17,672	1,228
Long-term liabilities	(2,220)	(1,254)	(100)
Minority interest	-	(7,971)	220
Balance of loans and investments which left at the time of exit from consolidation	-	(18,080)	1,427
Capital gain (loss) on sale or issuance to third party	(404)	33,059	(1,446)
Proceeds on credit	-	(2,532)	-
	<b>(121)</b>	<b>6,689</b>	<b>665</b>

**Statements of Cash Flows for the Year Ended December 31 (cont'd)****Annex E - Company initially consolidated**

	<b>Consolidated</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<b>NIS thousands</b>	<b>NIS thousands</b>	<b>NIS thousands</b>
Working capital, net (excluding cash and cash equivalents)	<b>(3,040)</b>	10,093	-
Fixed assets, net	<b>(5,274)</b>	(7,908)	-
Goodwill created upon acquisition	<b>2,998</b>	(2,209)	-
Long-term investments and debits	<b>(125)</b>	211	-
Other assets, net	<b>(13,087)</b>	(3,883)	-
Long term liabilities	<b>58</b>	1,006	-
Excess cost attributed to liability	<b>5,357</b>	-	-
	<b>(13,113)</b>	<b>(2,690)</b>	<b>-</b>

**Annex F - Issuance of capital in proportionate consolidation partnership**

	<b>Consolidated</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<b>NIS thousands</b>	<b>NIS thousands</b>	<b>NIS thousands</b>
Working capital, net (excluding cash and cash equivalents)	<b>(2,239)</b>	-	-
Other assets, net	<b>134</b>	-	-
Minority interest	<b>8,823</b>	-	-
	<b>6,718</b>	<b>-</b>	<b>-</b>