

Clal Electronics Industries Ltd.

Management Discussion and Analysis

As of December 31, 2000
(The data is in terms of NIS of December 31, 2000)

1. Description of the Company and its business environment

Clal Electronics Industries Ltd. (“the Company”) is an investment company which engages principally in the acquisition, establishment and development of companies operating primarily in the electronics sector. The Company plays an active role in the management of some of the investee companies.

On March 13, 2001, the Board of Directors of the Company decided to examine the advisability of merging the Company with Clal Industries and Investments Ltd. (“CII”) by way of exchange of shares, so that subsequent to the merger, CII would hold all of the shares of the Company. The Board of Directors also decided to authorize the Company’s management to formulate a merger proposal and to carry out negotiations with CII regarding the terms of the merger, and to submit the agreed upon terms to the Board of Directors for its consideration and approval. It was also decided to appoint a joint value appraiser who would calculate the number of shares which CII would allot to the shareholders of the Company (“the consideration”), if it would be decided to execute the merger. It was further decided to appoint a second economic appraiser to render an opinion on the fairness of the consideration, from the Company’s point of view.

The Company’s main holdings are as follows:

- ECI Telecom Ltd. (13.8% of the equity) (“ECI”) – This company engages in planning, development, production, marketing and servicing of communications equipment, including hardware and software.
- Scitex Corporation Ltd. (22.2% of the equity) (“Scitex”) – This is an investment company, specializing in the field of printing, which holds companies engaged in planning, development, production, marketing and servicing of conventional and digital printing systems used by the printing industry.
- Nova Measuring Instruments Ltd. (21.4% of the equity) (“Nova”) – This company engages in the development, production and marketing of optical measuring systems, for use in quality control, in real time, of the production processes in the semi-conductor industry.
- Jordan Valley Applied Radiation Ltd. (57.1% of the equity) (“Applied Radiation”) – This company engages in the development, production, marketing and servicing of equipment for analysis, measuring and control of processes. The systems are intended, inter alia, for the semi-conductor industry.
- Clal Venture Capital Fund, Limited Partnership (33.3% of the equity) (“the Fund”) – The Fund invested in companies engaged in start-up advanced technology companies.

- Infinity Israel Venture Capital Fund, Limited Partnership (18.5% of the equity) (“Infinity Israel Fund”) – The purpose of Infinity Israel Fund is to invest in companies engaged in research and development in the fields of communications, electronics, information science and medicine.
- Aprion Digital Ltd. (24.9% of the equity) (“Aprion”) – This company engages in the development of solutions for digital printing systems used by the printing industry.

The Company’s operating results are, to a large extent, influenced by capital gains and write-downs, and therefore are subject to sharp fluctuations between reporting periods. The Company’s operating results are also influenced by the results of its investee companies, mainly by the results of ECI and Scitex. The Group companies operate mainly in Israel and in the U.S., with most of the sales being outside of Israel.

The Group companies operate in competitive markets which are generally characterized by rapid technological changes and newly developed products. Considering the business environment in which it operates, the Group companies are required to invest in research and development.

The financial statements of the Group companies are adjusted for inflation on the basis of the changes in the exchange rate of the U.S. dollar.

The Group’s operation are influenced by various external factors – see section 8 below.

Review of the major companies*:

- a. In 2000, ECI reported a loss from continuing operations of NIS 44 million, exclusive of extraordinary expenses, compared to a profit of NIS 774 million last year. The operating results, inclusive of extraordinary expenses, amounted to a loss of NIS 369 million in 2000, compared to a profit of NIS 414 million last year. Sales amounted to NIS 4,729 million in 2000, representing an increase of 5% over last year’s sales.

In the fourth quarter of 2000, ECI showed a loss of NIS 243 million before net extraordinary expenses, compared to a profit of NIS 173 million last year. This loss include an inventory write-off, a provision for the decline in value of certain assets and reorganization expenses in an aggregate amount of NIS 228 million. The sales in the fourth quarter of 2000, amounted to NIS 1,238 million compared to NIS 1,162 million in the fourth quarter of 1999. Subsequent to balance sheet date, the business operations of ECI’s major divisions were transferred to 5 subsidiaries. In its financial statements, ECI noted that it is not certain that the split-up plan will be implemented as originally planned.

*This relates to the published financial statements of ECI, Scitex and Nova which were prepared in accordance with accounting principles generally accepted in the U.S.

- b. Scitex – As a result of the reorganization which was completed when the merger of the pre-print operation with Creo Inc. was concluded, Scitex became an investment company specializing in the printing field. The 2000 annual profit amounted to NIS 306 million, including the gain from the merger of the pre-print operation with Creo. The results of the fourth quarter of 2000, showed a loss of NIS 65 million.
- c. Other companies:
- Nova –Sales increased by 76%, from NIS 111 million in 1999 to NIS 196 million in 2000. Nova’s net profit in 2000, amounted to NIS 11 million compared to a loss of NIS 20 million in 1999 (the 1999 figure includes an extraordinary expense of NIS 16 million). The fourth quarter operating results of 2000 showed a profit of NIS 7 million while in the corresponding quarter of 1999 there was a loss of NIS 8 million. Fourth quarter sales in 2000, amounted to NIS 64 million compared to NIS 22 million in 1999.
 - These companies, which are in various stages of development, (Aprion, Applied Radiation and others) contributed NIS 30 million to the 2000 annual loss and NIS 12 million to the loss of the fourth quarter, compared to NIS 28 million and NIS 15 million respectively, in 1999.
 - The venture capital funds, the disposal of the investments in which began in the current year, contributed NIS 6 million to the profit in 2000.

2. Results of operations

- 2.1 The Company had a loss of NIS 371 million in 2000, compared to a profit of NIS 630 million in 1999 and a profit of NIS 460 million in 1998.

In the wake of a decline in value, of a non-temporary nature, in a number of its permanent investments, the Company wrote down such investments in the fourth quarter of 2000. The write-downs which involved Orckit, Tioga, VocalTec and ViryaNet aggregated NIS 248 million (see note 7 to the annual financial statements).

The 2000 annual loss includes extraordinary losses of NIS 265 million, mainly the write-downs described above as well as from non-recurring losses of ECI amounting to NIS 35 million, which were in part offset by a gain on the issue of Nova of NIS 35 million (in 1999 – after the offset of net extraordinary income of NIS 517 million).

ECI’s negative contribution to the 2000 operating results amounted to NIS 40 million (1999 – a positive contribution of NIS 109 million). Scitex’s negative contribution to the 2000 operating results amounted to NIS 33 million (1999 – a positive contribution of NIS 16 million).

Without including the extraordinary results, the 2000 loss would amount to NIS 106 million and the 1999 profit would amount to NIS 113 million.

The fourth quarter results of 2000 show a loss of NIS 368 million compared to a profit of NIS 37 million in 1999. These amounts include net extraordinary losses of NIS 279 million in 2000 and net extraordinary profits of NIS 5 million in 1999.

The transition from a profit in the fourth quarter of 1999 to a loss in the fourth quarter of 2000 derives mainly from the operating results of ECI and of Scitex.

Scitex included a gain of \$ 136 million in its second quarter 2000 financial statements, as a result of the consummation of the merger of its Pre-Print Division into Creo. This gain was calculated on the basis the fair value of the publicly traded Creo shares. The said gain is net of the write-off of research and development expenses in progress net of the related tax effect.

The financial statements of Scitex, which were prepared on the basis of U.S. GAAP, show a 2000 annual profit of \$ 76 million and a fourth quarter loss of \$ 16 million.

The Company states its investment in Scitex on the equity basis, after first adjusting the Scitex financial statements to Israeli GAAP. As a result of the adjustment of the Scitex financial statements to Israeli GAAP, Scitex's contribution to the operating results was a loss of NIS 33 million in annual 2000 and a loss of NIS 14 million in the fourth quarter of 2000.

- 2.2 The loss per NIS 1 par value of the share capital, comes to NIS 110 in 2000 compared to a profit of NIS 180 in 1999 and a profit of NIS 125 in 1998.

3. Financial position and sources of financing

The investments made during the current year were mainly financed by loans. As a result, the net volume of the Company's net debt as of December 31, 2000, amounted to NIS 450 million.

The total consolidated current assets amounted to NIS 119 million as of December 31, 2000, compared to NIS 406 million as of December 31, 1999.

The total consolidated liabilities amounted to NIS 487 million as of December 31, 2000, (of which NIS 344 million are current liabilities) compared to NIS 335 million as of December 31, 1999.

The Company's own resources as of December 31, 2000, which include the shareholder's interest and the minority interest, amounted to NIS 1,342 million. This constitutes 73% of the total consolidated assets, compared to 84% as of December 31, 1999.

4. Principal changes in investments

- 4.1 In March, the Company invested NIS 24 million in PowerDsine Ltd. in return for 8.9% of the equity of PowerDsine. PowerDsine is engaged in the development, manufacturing and marketing of unique power components for the telecommunications industry.
- 4.2 In March, the Company invested NIS 20 million in SmartLink Ltd. in return for 5.5% of its equity. SmartLink manufactures a communications software program, designated to replace modem cards in PCs.
- 4.3 In March, the Company invested NIS 51 million in convertible debentures issued by Orckit. Following the spin-off of Orckit, the debentures may be converted into shares of Orckit and Tioga.
- 4.4. In March, the Company converted the debentures it held into shares of ECI. As a result of the conversion, the Company now holds 13.8% of the equity of ECI.
- 4.5 In the framework of a rights issue by Applied Radiation in February, the Company invested NIS 20 million in its equity. As a result, the Company now holds 57.1% of the equity of Applied Radiation.
- 4.6 During the current year, the Company purchased additional shares of Scitex for an aggregate amount of NIS 62 million. Following the purchase, the Company holds 22.2% of the equity of Scitex.
- 4.7 In April, Nova raised NIS 199 million in an initial public offering carried out in the United States. As a result of the offering, the holding of the Company in Nova decreased and it recognized a gain of NIS 35 million. As a result of the acquisition of additional shares in the course of trading, the holding of the Company in Nova after the offering is 21.41%.
- 4.8 Concurrent with the investment of CII, the Company invested NIS 28 million in ViryaNet Ltd., during the current year. In September, ViryaNet raised NIS 120 million in an initial public offering carried out in the United States. As of December 31, 2000 the Company holds 6.5% in ViryaNet. ViryaNet is engaged in the development and marketing of software products for the service providers and field work teams, enabling remote control management.
- 4.9 During the year, the Company purchased 4.9% of the share capital of VocalTec on the stock market, in consideration of NIS 44 million. VocalTec develops, manufactures and markets products enabling telephone calls over the internet.
- 4.10 In October 2000, the Company invested NIS 40 million in shares of, Saifun Semiconductors Ltd. conferring a 2.5% holding in Saifun. Saifun develops technology for the manufacture of memory components for FLASH technologies.
- 4.11 During the current year, the Company has undertaken, parallel to the commitment of CII, to invest \$ 15 million, in Infinity II Venture Capital Fund, \$ 2.5 million in Star II, \$ 3 million in Genesis II and \$ 2.5 million in Hyperion Ltd.

5. Acquisition of Company shares

During 2000, a wholly-owned subsidiary purchased additional shares of the Company for NIS 4.7 million. As of December 31, 2000, the subsidiary holds 8.9% of the Company's share capital.

In March 2001, the Company purchased all its shares held by the subsidiary, in consideration of NIS 89 million.

6. Subsequent events

After December 31, 2000, the stock market value of certain marketable investments of the Company declined, as detailed in notes 6a and 7a to the financial statements.

7. Effect of external factors

The state of capital markets in the world, especially of the stock markets, may affect the Company's value, its operating results and the operating results of the Group companies.

The government's monetary policy in general, including changes in the price of financial resources and a currency exchange devaluation policy, may have a material effect on the profitability of the Group.

Budgets of government agencies, in general, and those of national security agencies in particular, affect the operations of certain companies in the group and changes in those budgets may materially affect the operations in those areas.

The directives of the Supervisor of Banks include restrictions according to which, the liability of a group of borrowers to a bank may not exceed a certain percentage of the capital of the said bank. Since the Company and its subsidiaries are considered as being part of the "IDB Holding Company Ltd. group of borrowers" the above directives may limit the possibility of some of the Israeli banks to significantly increase the volume of the Company's credit line.

8. Quality reporting of market risk exposure and methods of its management

The following data relates to Clal Electronic Industries Ltd. and to its wholly-owned subsidiaries (hereafter – "the Entity"):

- 8.1** Mr. Gonen Bieber, the CFO, is the person responsible for managing the financial risks of the entity ("Mr. Bieber"). Mr. Bieber is the Deputy General Manager in Charge of Finance of Clal Industries and Investments Ltd. He holds academic degrees.

8.2 Market risks¹ to which the Entity is exposed

The Entity is exposed to a variety of market risks in the ordinary course of its business, mainly changes in the price of marketable securities which can influence the value of the Entity's holdings in its investee companies, its operating results and the balance between the assets and liabilities linked to foreign currency or to the Consumer Price Index ("CPI").

8.3 The Entity's market risk management policy

The Entity holds a large portfolio of marketable securities of its investee companies. As a general rule, the Company does not hedge the market risks involved in its investments in marketable securities, inter alia, because of the large volume of the Company's investments in marketable securities, the dispersion of the investments in Israel and abroad, the dispersion of the investments over a large number of securities, as well as because of the legal limitations on the purchase of various derivatives.

The Entity attempts to balance the linkage bases of its financial assets and its liabilities, as far as possible, as well as to match the average life of its financial assets to the average life of its liabilities.

8.4 Control policy and its implementation

The Board of Directors approves, from time to time, usually once a year, the volume of hedging transactions which the Entity may execute and the authority of the Entity's officers. In accordance with decisions of the Board of Directors, the Entity 's management may from time to time:

- a. Execute hedging transactions, according to its best judgement, including forward transactions, options and other financial instruments (in respect of principal or interest), for the purpose of reducing or completely neutralizing risk exposures which may arise from time to time as a result of the financial structure of the Entity.
- b. Maintain an excess of liabilities or an excess of assets, which are denominated in or linked to NIS, not to exceed \$ 100 million.

The hedging transactions are handled by the CFO, who is authorized to execute hedging transactions for the purpose of implementing the Entity's policies. The CFO reports to the CEO on a current basis on the execution of the hedging transactions. Management is required to report to the Investment Committee of the Board of Directors if the need arises, but not less frequently than once a year.

The Entity executed hedging transaction during the current year, the effect of which on the financial statements, is insignificant.

¹Within the meaning of this term used in the guidelines issued by the Securities Authority on November 29, 1999.

8.5 Subsequent events

No significant events, relating to market risks, were recorded by the Entity subsequent to balance sheet date, other than those disclosed in paragraph 6 above.

9. Benefits to executive employees

In determining salaries, bonuses and allotment of option warrants, the Board of Directors, inter alia, took into account the following considerations:

The status and position of each of the executive employees and that individual's contribution to the operations and advancement of the Company. The considerations pertaining to the benefits included, inter alia, the business volume of the Company, income and the yield rate on shareholder's equity and the meeting of goals and the work program. The main consideration regarding the granting of option warrants, exercisable over the long term, was the encouragement of a long-term connection and commitment of each executive employee to the Company, by participating in the Company's capital and thus in the results of its initiatives, development and management activities.

We wish to thank the managers of the Group companies and their employees for their contribution to the advancement and development of the Group.

Daniel Barnea
CEO

Meir Shannie
Chairman of the Board of Directors

CLAL ELECTRONICS INDUSTRIES LTD.
SELECTED CONSOLIDATED STATEMENT OF INCOME DATA

In thousands of shekels of December 2000

	December 31	
	2000	1999
	(Audited)	
Assets		
Current assets	119,176	405,585
Investments	1,675,469	1,611,108
Fixed and other assets	34,407	30,334
	1,829,052	2,047,027
Liabilities and shareholders' equity		
Current liabilities	343,944	332,993
Long-term liabilities	142,643	1,555
Minority interests	19,381	15,584
Shareholders' equity	1,323,084	1,696,895
	1,829,052	2,047,027

CLAL ELECTRONICS INDUSTRIES LTD.
SELECTED CONSOLIDATED STATEMENT OF INCOME DATA
 In thousands of shekels of December 2000

	For the year ended		
	2000	December 31	1998
	(Audited)		
Revenues	85,614	718,074	593,235
Costs and expenses	461,754	80,468	104,655
Income (loss) before taxes	(376,140)	637,606	488,580
Taxes on income	474	6,765	26,877
Income (loss) after taxes	(376,614)	630,841	461,703
Minority interests	5,466	(1,181)	(1,681)
Net income (loss)	(371,148)	629,660	460,022
Earnings (loss) per NIS 1 of par value of shares (in shekels)	(110.39)	179.67	124.75