

**CLAL INDUSTRIES AND INVESTMENTS LTD.**

**MANAGEMENT DISCUSSION AND ANALYSIS**

**FOR THE QUARTER TO MARCH 31, 2002**

## 1. **Description of Company**

Clal Industries and Investments Ltd. (“the Company”) (“CII”) is an investment company, whose principal holdings are in the manufacturing and high-technology sectors. The Company is controlled by IDB Development Corporation Ltd.

The Company is principally engaged in the acquisition, establishment and development of companies in various industries, and takes an active role in the formulation of strategy, particularly so when it is the largest investor. The Company has access to a range of commercial opportunities, remaining constantly alert for investments with exceptional potential returns. Simultaneously, the Company aspires to enhance the value of its existing investments, with a view to realizing those investments at the appropriate time.

The CII group of companies is engaged in a variety of segments, which primarily include: cement, textiles, high-technology and electronics, paper and cardboard, biotechnology, communications, and the management of venture capital funds.

The Company’s Board of Directors has approved the basic principles of its new long-term business plan which management, together with a strategy consulting company, has been formulating during recent months. The basic principles include, inter alia, stressing the central importance of developing management resources; focusing on a limited number of significant investments which carry potential for sustained growth and which also provide the Company with the opportunity to exercise considerable influence over performance with a view to enhancing the value of the investment; placing emphasis on areas of rapid growth; and extending support and encouragement with respect to long-term strategies of investee companies through a continuous process of review and adjustment. The Company has thus adjusted its operating profile through the adoption of advanced management and business tools.

The Company’s operating results are affected, to a significant extent, by capital gains and write-offs. Accordingly, significant fluctuation is likely in the Company’s results as between the various reporting periods.

The Company views its contribution to the community as a central plank in its business vision.

## 2. Operating results

- A. Income for the period of account amounted to NIS 2 million, as compared to a loss of NIS 225 million in the corresponding period of the previous year and a loss of NIS 685 million for the whole of 2001.

The income reflects the effect of net positive non-recurring factors amounting to NIS 27 million. Principal amongst these factors were the benefit derived from the reduction in the provision for a bank guarantee made available to Barak as required by the terms of its license (NIS 36 million), and the expense incurred on account of efficiency measures undertaken at one of the plants of Nesher (NIS 10 million). The corresponding period of the previous year saw the effect of net negative non-recurring factors totaling NIS 169 million.

The decrease in current loss-making is primarily due to the transition from the incurring of financing expenses to the earning of financing income, as well as to the decrease in losses incurred by ECI. Both of these positive factors were partly offset by the reduction in the profitability of Nesher.

The net loss for the quarter of ECI, as computed in accordance with accounting principles generally accepted in Israel, amounted to NIS 246 million. This loss includes write-downs relating to a decline of NIS 252 million in the value of intangible assets. The above write-downs had no effect on the Company's financial statements, however, in view of the excess of the book value over the consideration paid, which had been attributed to goodwill and to the intangible assets written down by ECI.

The income per NIS 1 share for the period under review amounted to NIS 0.01, as compared to a loss of NIS 1.61 for the corresponding period of the previous year and a loss of NIS 4.63 for the whole of 2001.

- B. We set out below selected data from the financial statements of the principal investee companies (in millions of shekels - rounded):

	<u>Sales</u>		<u>Net Income (Loss) (*)</u>	
	<u>For the three months ended March 31</u>		<u>For the three months ended March 31</u>	
	<u>2002</u>	<u>2001</u>	<u>2002</u>	<u>2001</u>
Mashav	302	372	2.5	22
ECI	909	1,179	(243)	(1,197)
Scitex	283	299	(5)	(60)
AIPM	116	139	9	12
Kitan	193	201	2	10
Polgat	162	170	6	3
Barak	169	153	(5)	(39)
Fundtech	43	61	(18)	(3)

(\*) Net income (loss) includes the effects of non-recurring factors.

C. Review of operations of principal companies in first quarter <sup>(1)</sup>

Nesher – The quarter saw a 21% reduction in the sales of cement as compared to the corresponding quarter of the previous year, which reduction was due primarily to a 16% decrease in sales volume. The net income for the quarter of companies in the cement sector totaled NIS 10 million (before accounting for a non-recurring expense of NIS 10 million), as compared to NIS 23 million for the corresponding quarter of the previous year.

The decrease in sales and income was due mainly to the increase in imports of cement into Israel (at dumping prices), the crisis in the construction industry, and the security situation. In March 2002, Nesher reached an understanding with the Supervisor of Restrictive Trade Practices, under the terms of which Nesher would, under certain conditions and in relation to a specific transaction, be permitted to compete with the prices of the imported cement, without incurring any obligation to be bound by the price set by the company for that particular transaction in relation to prices quoted to other customers for similar transactions. This arrangement is of a temporary nature only, and may lapse if certain conditions were to obtain. Nesher also lodged a complaint with the Supervisor of Trade Levies at the Foreign Trade Directorate in connection with the import of cement at dumping prices. The Supervisor subsequently opened an investigation into this matter.

ECI – ECI reported a loss of NIS 37 million from continuing operations, before adjustment for non-recurring expenses, with respect to the quarter under review, as compared to a loss of NIS 196 million for the corresponding quarter of the previous year. The loss, after accounting for non-recurring expenses, amounted to NIS 243 million, as compared to a loss of NIS 1,197 million for the corresponding quarter of the previous year.

Despite the 23% fall in sales, gross profit increased from NIS 295 million (before inventory write-offs) in the corresponding quarter of the previous year, to NIS 335 million in the first quarter of 2002. During the course of the quarter, the company's liquidity position continued to improve. The improvement was mainly attributable to operating cash flows (NIS 376 million) and to capital mobilization (NIS 233 million).

During 2001, class actions were brought against ECI and some of the company's directors. In the view of management, the actions brought by the plaintiffs are completely lacking in substance. The parties have signed a memorandum of principles in order to settle the actions (see also Note 4D to the condensed interim financial statements).

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(1) The surveys of ECI, Scitex and Fundtech are based on published financial statements prepared in accordance with accounting principles generally accepted in the U.S.A.

Scitex – Sales for the quarter, which totaled NIS 283 million, decreased by 5% in comparison with sales for the corresponding quarter of the previous year, but increased by 3% in comparison with sales for the final quarter of 2001.

The reduction in the level of expenditures implemented by Scitex to enable the company to adapt to the recessionary market conditions in which it currently operates, has led to a decrease in the loss for the quarter under review (in comparison with that for the corresponding quarter of the previous year), before adjustment for the losses of associated companies, these losses amounting to NIS 8 million in the first quarter of 2001 and nil in the quarter under review.

AIPM - Net income for the first quarter amounted to NIS 9 million, in comparison with NIS 12 million for the corresponding quarter of the previous year and NIS 8.5 million for the final quarter of 2001.

Sales decreased by 16%, from NIS 139 million in the corresponding quarter of the previous year, to NIS 116 million in the quarter under review. This situation arose as a result of a decline in local demand and the intensified competition - a factor which led to an erosion of dollar selling prices. The principal associated companies, Hogla-Kimberley and Neuziedler Paper, Hadera, also suffered from a decline in sales in monetary terms, despite the growth of sales volume. Efficiency measures taken by all AIPM group companies, led to a reduction in salary costs and further manufacturing costs. These factors, together with an erosion of salary costs in dollar terms and a decrease in energy costs, moderated the decline in income in comparison with the corresponding quarter of the previous year, and led to an increase in income in comparison with the results for the final quarter of 2001.

Kitan - Sales decreased by 4%, and totaled NIS 193 million for the quarter under review, as compared to NIS 201 million for the corresponding quarter of the previous year. Operating income decreased from NIS 14.5 million for the corresponding quarter of the previous year to NIS 3 million for the quarter under review. The worsening of results stems mainly from two factors: the slow-down in the retail operations of the Golf group, and the decision to defer delivery of an order to a principal customer of Kitan Industries to the second quarter of the year.

Net income for the quarter amounted to NIS 2 million, as compared to NIS 10 million for the corresponding quarter of the previous year.

Polgat - Gross profit increased from NIS 28 million for the corresponding quarter of the previous year (a gross profit rate of 16%) to NIS 35 million for the quarter under review (a gross profit rate of 21%). The improved results, despite a fall in sales, are attributable to the decrease in labor costs in consequence of the continuing transfer of manufacturing operations to locations outside Israel.

During the quarter, an agreement was signed with the employees and the Histadrut Labor Federation for the purpose of implementing a program to reduce the level of manufacturing operations undertaken by Bagir in Israel.

Towards the end of the first quarter of 2002, Polgat acquired further shares in Guney-Polgat, such that, subsequent to the further acquisition, Polgat possesses a 51% holding in that company.

Barak - The increase in revenues continued, reaching NIS 169 million in the quarter under review, as compared to NIS 153 million in the corresponding quarter of the previous year – an increase of 10%. Barak ended the quarter with earnings before taxes, depreciation and financing expenses of NIS 42 million, as compared to NIS 15 million for the corresponding quarter of the previous year. The improvement in trading results is attributable to a significant expansion in all fields of operation, combined with the implementation of efficiency measures. This is reflected by the achievement of operating income of NIS 31 million for the quarter under review, as compared to NIS 1 million for the corresponding quarter of the previous year.

Fundtech - Revenues for the quarter amounted to NIS 43 million, as compared to NIS 61 million for the corresponding quarter of the previous year. A decline in revenues from the licensing of software led to a 30% decrease in sales. The market conditions that incline the banking sector to defer investment decisions continue to affect the company's trading results. This situation has led to an aggravated loss-making position, the loss of NIS 3 million for the first quarter of 2001 now having increased to NIS 18 million for the quarter under review. The cost-saving measures instituted by Fundtech have led to a decrease of the loss for the quarter under review in comparison with that for the final quarter of 2001.

In general, the results of Group companies for the first quarter of the year were affected by the general economic recession in world markets and the domestic market, the security situation in Israel and in the United States, and the crisis in the capital market, especially in the technology and communications sectors. In the domestic market, the decrease in demand and the intensifying competition caused an erosion of selling prices and a decline in profitability. Group companies that sell overseas were particularly affected by the decrease in purchases of plant and equipment by companies operating in various sectors. The overall effect of the factors outlined above is partly offset by reorganization and efficiency measures taken by a significant number of Group companies.

The continuing recession, both in the domestic economy and in world markets, will continue to have an adverse effect on the performance of Group companies.

### 3. **The financial position and sources of finance**

The consolidated balance sheet reflects a working capital deficiency of NIS 18 million. As of balance sheet date, short-term liquid assets reflected in the consolidated balance sheet amounted to NIS 202 million; these assets are included within short-term investments and cash and cash equivalents. The consolidated balance sheet reveals a quick ratio of 0.52 (December 31, 2001 – 0.49). The principal sources of funds were current operations (NIS 118 million), the proceeds of long-term loans (NIS 145 million), and the proceeds of an issuance of debentures (NIS 105 million). The funds were principally applied towards the repayment of short-term credit (NIS 164 million), investment in companies (NIS 62 million) and investment in long-term loans and deposits (NIS 51 million).

As of March 31, 2002, the Company's shareholders' equity amounted to NIS 2,942 million, as compared to NIS 2,896 million as of the end of the previous year. The minority interest, as of March 31, 2002, was NIS 108 million, as compared to NIS 127 million as of the end of the previous year. The net funds represented by the 2% increase in the Company's shareholders' equity and the 15% decrease in the minority interest, together constituted a source of finance for 52% of the Group's assets.

The Group's external long-term sources of finance totaled NIS 1,302 million as of March 31, 2002, as compared to NIS 1,090 million as of the end of the previous year. Approximately 23% of these funds is repayable during the course of the next year.

### 4. **Principal changes in investments**

4.1 In February 2002, the Company acquired additional shares of ECI for NIS 16 million. Subsequent to the acquisition and to a private placement of shares, the Company's holding in ECI was 14.5%.

4.2 During the first quarter of the year, the Company acquired additional shares of Fundtech for NIS 7 million. Subsequent to this acquisition and to further acquisitions made after the end of the quarter under review, the Company's holding in Fundtech is now 32%.

4.3 In addition to the above, during the first quarter of 2002, the Company invested, both directly and indirectly (through wholly-owned subsidiaries) NIS 36 million (after adjustment for inflation) in further companies as follows:

	<b>Millions of shekels</b>
High technology and electronics	21
Biotechnology	4
Venture capital funds	8
Miscellaneous sectors	3

## 5. **Subsequent events**

- 5.1 In April 2002, an agreement was finalized for the sale of the Company's holdings in Lasers International Technologies Ltd. ("Lasers") to a group headed by the managing director of Lasers. As consideration for the sale of its holdings, the Company was paid an amount of \$7 million ("the initial consideration"). Under certain conditions, the consideration could rise to \$9.5 million. The net gain arising on the sale of the Company's holdings in Lasers, on the basis of the initial consideration, is NIS 12 million, which gain will be reflected in the Company's financial statements for the second quarter of 2002.
- 5.2 During the period commencing on March 31, 2002 and ending on the date on which the financial statements for the first quarter of 2002 were approved, the Company invested NIS 16 million in various companies, both directly and through wholly-owned subsidiaries.

## 6. **Analysis of market risks to which the Group is exposed and the management of those risks**

This report relates to the Company and its wholly-owned subsidiaries ("the Corporation"):

- 6.1 The officer responsible for managing the financial risks to which the Corporation is exposed, is Mr. Gonen Bieber, VP Finance ("the responsible officer").

### 6.2 Market risks to which the Corporation is exposed

The Corporation is exposed to a variety of market risks during the ordinary course of its business. The principal such risks relate to changes in the prices of marketable securities which may affect the market value of the Corporation, and which are also likely to affect its trading results and shareholders' equity. In addition to the above, the Corporation is also exposed to changes in interest rates, the pace of inflation, and movement in currency exchange rates, all of which affect, both directly and indirectly, its trading results and the value of its assets and liabilities.

### 6.3 The Corporation's policy with respect to the management of market risks

The Corporation holds marketable securities in a wide range of investee companies. As a general rule, the Corporation does not hedge its investments in marketable securities, in view of, amongst other factors, the large extent to which the Corporation has invested in marketable securities, the spread of investments both in Israel and overseas, the spread of investments in different securities and sectors, and in addition, the legal restrictions on the purchase of various derivative instruments.

The Corporation attempts to match, as far as possible, the linkage bases of its financial assets with those of its liabilities, and the length of the average life of its financial assets with the length of the average life of its liabilities.

#### 6.4 Methods of supervision and implementation of policy

From time to time, generally once a year, the Board of Directors determines the extent of the hedging transactions permitted, and the authority of the Corporation managers. In accordance with a resolution of the Board of Directors, management is authorized:

- a) to implement, from time to time, at its discretion, hedging transactions, including forward exchange transactions and transactions in options and other financial instruments (with respect to principal or interest), for the purpose of reducing or eliminating completely, such exposure as may arise from time to time in consequence of the financial structure of the Corporation;
- b) to hold, from time to time, surplus liabilities or foreign currency-linked monetary assets, to an extent that does not exceed \$250 million.

The transactions are implemented by the responsible officer, who is authorized to implement such hedging transactions as are required in order to comply with Corporation policy. The responsible officer reports to the managing director on a regular basis with respect to the implementation of the hedging transactions. Management is required to report to the Board of Directors as necessary, and must, in any event, report at least once a year.

During the period of account, the Corporation implemented hedging transactions which had a minimal effect on the statement of operations.

## 6.5 Consolidated Linkage Basis Report – in millions of shekels of March 2002

	<u>Index-linked</u>	<u>Dollar-linked</u>	<u>Linked to other foreign currency</u>	<u>Unlinked</u>	<u>Non-financial balances</u>	<u>Total</u>
<u>As of December 31, 2001</u>						
Current assets	77	227	84	320	696	1,404
Non-current assets	42	71	0	9	4,214	4,336
Current liabilities	(233)	(190)	(87)	(987)	(15)	(1,512)
Non-current liabilities	(740)	(36)	(8)	(63)	(485)	(1,332)
Total balance sheet balances (net)	(854)	72	(11)	(721)	4,410	2,896
<u>As of December 31, 2000</u>						
Current assets	87	130	54	359	776	1,406
Non-current assets	82	113	0	12	5,712	5,919
Current liabilities	(115)	(565)	(126)	(1,644)	(11)	(2,461)
Non-current liabilities	(275)	(198)	(25)	(212)	(1,037)	(1,747)
Total balance sheet balances (net)	(221)	(520)	(97)	(1,485)	5,440	3,117

## 6.6 Subsidiaries

Nesher, Polgat and Kitan are exposed to fluctuations in the prices of raw materials and energy, and to changes in exchange rates and interest rates, all of which affect the revenues and expenditures of these companies.

The above companies match their sources of income and their expenditures with respect to each foreign currency. From time to time, Polgat and Kitan engage in hedging transactions with foreign currency derivative instruments in order to reduce exposure. Nesher engages in commodity and various energy product contracts of up to one year, as a hedge against unexpected price increases in the world market.

## 6.7 Derivative instrument positions

We set out below the derivative instrument positions of Polgat and Kitan as of December 31, 2001. As of the above date, neither the Corporation nor Neshet had derivative instrument positions. The data below is expressed in millions of shekels of March 2002:

	<b>Dollar/Shekel</b>								
	<b>Nominal value</b>				<b>Fair value</b>				
	<b>Up to 1 year</b>		<b>Over 1 year</b>		<b>Up to 1 year</b>		<b>Over 1 year</b>		
	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	
<u>Forward contract</u>									
For hedging - recognized for accounting purposes								35	(*)
Net for hedging								1	(*)

	<b>Euro/Shekel</b>								
	<b>Nominal value</b>				<b>Fair value</b>				
	<b>Up to 1 year</b>		<b>Over 1 year</b>		<b>Up to 1 year</b>		<b>Over 1 year</b>		
	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	
<u>Forward contract</u>									
For hedging - recognized for accounting purposes								11	(*)

	<b>Pound sterling/Shekel</b>								
	<b>Nominal value</b>				<b>Fair value</b>				
	<b>Up to 1 year</b>		<b>Over 1 year</b>		<b>Up to 1 year</b>		<b>Over 1 year</b>		
	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	<b>Long</b>	<b>Short</b>	
<u>Options</u>									
For hedging - recognized for accounting purposes									
Purchase of put options								36	(*)
Writing of call option								40	(*)

**Dollar/Pound sterling**

Nominal value				Fair value			
Up to 1 year		Over 1 year		Up to 1 year		Over 1 year	
Long	Short	Long	Short	Long	Short	Long	Short

Options

For hedging -  
recognized for  
accounting  
purposes

Purchase of put options	9				(*)
Writing of call option	10				(*)

**Euro/Pound sterling**

Nominal value				Fair value			
Up to 1 year		Over 1 year		Up to 1 year		Over 1 year	
Long	Short	Long	Short	Long	Short	Long	Short

Options

For hedging -  
recognized for  
accounting  
purposes

Purchase of put options	19				(*)
Writing of call option	20				(*)

(\*) Less than NIS 1 million

## 6.8 Subsequent events

In the period between December 31, 2001 and the date of approval of the financial statements for the first quarter of 2002, the principal events in the area of market risk were: a rise of approximately 11% in the exchange rate of the U.S. dollar; a rise of approximately 4% in the Consumer Price Index, in the wake of which domestic interest rates are expected to increase; and further declines in the stock exchange values of a number of marketable investments held by the Company.

7. **Remuneration of senior employees**

In March 2002, approval was given by the Board of Directors for two employees to join the Company's option plans as from August 2001. The two employees will be issued with 154,287 options, which may be exercised for up to 154,287 shares.

In addition, in April 2002, the Company's Board of Directors approved a proposal to amend the terms of the Company's option plans as from January 2001. In accordance with the amendment, the exercise prices of options have been adjusted (see also Note 7 to the condensed interim financial statements).

8. **Indemnity arrangements**

In April 2002, the Company in general meeting approved the granting of indemnities, under the terms of which the Company has undertaken to indemnify its officers. The total indemnification to be paid by the Company shall not exceed 25% of its shareholders' equity (see also Note 8 to the condensed interim financial statements).

We wish to thank the Group's directors and employees for their contribution to the advancement and development of the Group.

.....  
**LEON RECANATI**  
Chairman of the  
Board of Directors

.....  
**MEIR SHANNIE**  
General Manager

# CLAL INDUSTRIES AND INVESTMENTS LTD.

## SELECTED CONSOLIDATED BALANCE SHEET DATA

In millions of shekels of March 2002

	<u>March 31</u>		<u>December 31</u>
	<u>2002</u>	<u>2001</u>	<u>2001</u>
	<u>(Unaudited)</u>		<u>(Audited)</u>
<u>Assets</u>			
Current assets	1,427	1,580	1,404
Long term deposits, loans and receivables	73	79	45
Investments	2,234	2,853	2,199
Fixed assets, other assets and deferred expenses	<u>2,081</u>	<u>2,788</u>	<u>2,092</u>
	<u>5,815</u>	<u>7,300</u>	<u>5,740</u>
<u>Liabilities and Shareholders' Equity</u>			
Current liabilities	1,445	2,811	1,512
Long-term liabilities	1,320	920	1,205
Minority interests	108	623	127
Shareholders' equity	<u>2,942</u>	<u>2,946</u>	<u>2,896</u>
	<u>5,815</u>	<u>7,300</u>	<u>5,740</u>

# CLAL INDUSTRIES AND INVESTMENTS LTD.

## SELECTED CONSOLIDATED BALANCE SHEET DATA

In millions of shekels of March 2002

	For the three months ended March 31		For the year ended December 31
	2002 (Unaudited)	2001	2001 (Audited)
Revenues	632	626	2,581
Costs and expenses	<u>625</u>	<u>961</u>	<u>3,374</u>
Income (loss) before taxes	7	(335)	(793)
Taxes on income	<u>4</u>	<u>26</u>	<u>117</u>
Income (loss) after taxes	3	(361)	(910)
Minority interest in losses (earnings) of subsidiaries, net	<u>(1)</u>	<u>136</u>	<u>225</u>
Net income (loss)	<u><u>2</u></u>	<u><u>(225)</u></u>	<u><u>(685)</u></u>
Earnings (loss) per NIS 1par value of share capital (in NIS)	<u><u>0.01</u></u>	<u><u>(1.61)</u></u>	<u><u>(4.63)</u></u>